S. Hrg. 99-~~000~~ 981

AMENDING THE AGRICULTURE AND FOOD ACT OF 1981

HEARING

BEFORE THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

S. 744

[Report No. 99-147]

TO AMEND THE AGRICULTURE AND FOOD ACT OF 1981 TO PROVIDE PROTECTION FOR AGRICULTURAL PURCHASERS OF FARM PRODUCTS

OCTOBER 9, 1985

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

U.S. GOVERNMENT PRINTING OFFICE
55-188 O WASHINGTON : 1986

S241-15

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

JAKE GARN, Utah, *Chairman*

JOHN HEINZ, Pennsylvania
WILLIAM L. ARMSTRONG, Colorado
ALFONSE M. D'AMATO, New York
SLADE GORTON, Washington
MACK MATTINGLY, Georgia
CHIC HECHT, Nevada
PHIL GRAMM, Texas

WILLIAM PROXMIRE, Wisconsin
ALAN CRANSTON, California
DONALD W. RIEGLE, Jr., Michigan
PAUL S. SARBANES, Maryland
CHRISTOPHER J. DODD, Connecticut
ALAN J. DIXON, Illinois
JIM SASSER, Tennessee

M. Danny Wall, *Staff Director*
Kenneth A. McLean, *Minority Staff Director*
James E. Boland, *General Counsel*
Virginia Anne Housum, *Counsel*

CONTENTS

WEDNESDAY, OCTOBER 9, 1985

Page
Opening remarks of Senator Garn 1
    Opening statement 1
Opening statements of:
    Senator Mattingly 31
    Senator D'Amato 107
    Senator Dixon 111
    Senator Gorton 145
Senate bill S. 744 3

WITNESSES

Mark Andrews, U.S. Senator from the State of North Dakota 9
    Problem extends well beyond buyers and lenders 10
    Prepared statement 12
        North Dakota central notice law 13
        Suggested amendment language 16
Charles W. Stenholm, U.S. Representative from the State of Texas 17
    Position of House Agriculture Committee 17
    Prepared statement 19
Steve Gunderson, U.S. Representative from the State of Wisconsin 23
    Give the farmer the same protection as anyone else 25
    Problem of multistate law 25
    Prepared statement 26
Howell Heflin, U.S. Senator from the State of Alabama 30
    Prepared statement 30
Kathleen Lawrence, Deputy Under Secretary for Small Community and Rural Development, USDA 32
    Prepared statement 32
    Response to written questions 176
Marlin D. Jackson, banking commissioner for the State of Arkansas 37
    No need for Federal intrusion 37
    Effects on loan classifications 38
    Prepared statement 39
    Response to written questions 152
Panel discussion:
    $5 billion for short-term operating loans 43
Glen E. Lemon, chairman of the board, First Bank & Trust Co., Booker, TX; vice chairman, Government Relations Council, American Bankers Association 44
    Prepared statement 45
        Preemption of State law 50
        Buyer's risk 52
        Farm products and inventory 54
        Effects on agricultural credit 55
        Conclusion 57
    Response to written questions 178
Bud Gerhart, president, First National Bank, Newman Grove, NE; chairman, rural agriculture committee, Independent Bankers Association of America 61
    Prepared statement 62
    Response to written questions 174
Gene Swackhamer, president, Farm Credit Bank of Baltimore; on behalf of the Farm Credit Council 67

Page

Gene Swackhamer, president, Farm Credit Bank of Baltimore; on behalf of the Farm Credit Council—Continued

Prepared statement ... 68
FCC/NCFC products lien alternative proposal ... 75
FCC/NCFC alternative bill ... 76
Response to written questions ... 172

Panel discussion:

Wide diversity of opinion ... 80
John R. Miller, chief executive officer, E.A. Miller & Sons Packing Co., Hyrum, UT ... 81
Recent insolvency problem ... 81
Prepared statement ... 83
Marion Luckey, Jr., pecan processor, Harlem, GA ... 89
Pecan marketing practices ... 89
History of liens in the pecan industry ... 89
The effect on the grower ... 90
Prepared statement ... 91
Interests of Tracy-Luckey Co., Inc. and pecan purchasing practices ... 91
Prior loss experience ... 92
Current conditions ... 92
In support of the clear title section ... 93
Attachment A: Letter from the Farmers Home Administration concerning a clear title of indebtedness ... 95
Attachment B: Divine, Wilkin, Deriso, Raulerson & Fields, letter to show indebtedness for title of pecans purchased ... 96
Jim D. Gaetano, president, Pennsylvania Livestock Auction Association, Inc. ... 97
Represent 27 livestock markets ... 97
Prepared statement ... 99
Response to written questions ... 167
Dale C. Seyler, president, Colorado Commodity Traders, Inc., Greeley, CO ... 101
Prepared statement ... 101

Panel discussion:

Banking as well as an agriculture issue ... 108
No reason for double jeopardy ... 109
Need for a compromise ... 110
Joann Smith, president, National Cattlemen's Association ... 113
Prepared statement ... 13
Response to written questions ... 158
John White, Jr., president, Illinois Farm Bureau; on behalf of the American Farm Bureau Federation ... 117
Scope of the problem is on a small percentage of producers ... 117
Prepared statement ... 119
Response to written questions ... 164
John Rabbe, farmer, Trimont, MN ... 121
Prepared statement ... 122
Glenn Rogers, farmer, Wahpeton, ND ... 124
Applications for FHA loans will increase ... 124
Seymour Johnson, farmer, Indianola, MS; chairman, farm policy committee, Delta Council, accompanied by W.T. Robertson, president, Delta Council ... 125
Opposed to deletion of present exception ... 125
Prepared statement ... 127

Panel discussion:

Two sides to the equation ... 130
Use Illinois system as basis for cooperation ... 131
Grudging concessions to each other ... 132
William B. Brandt, general counsel, Nebraska Bankers Association ... 133
Lack of understanding and knowledge ... 133
Favored treatment of livestock markets in Nebraska ... 135
Development of a central indexing system ... 136
Prepared statement ... 137
Dan A. Gunderson, executive director, Minnesota Agri-Growth Council, Inc. ... 145
Losses in Minnesota ... 146
Support for S. 744 ... 147
Prepared statement ... 148
Response to written questions ... 161

Panel discussion:

Federal preemption based on interstate movement ... 150

Page

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

Federal Deposit Insurance Corporation, response to Senator Garn on S. 744 162
Agricultural Banking Institute 190
Comptroller of the Currency 191
Kansas Bankers Association 193
National Broiler Council 203
National Conference of Commissioners on Uniform State Laws 211
National Grange 216
National Independent Dairy-Foods Association 218
North Dakota Bankers Association 223
Pennsylvania Bankers Association 226
The Robert Morris Associates 227
South Dakota Bankers Association 230
Utah Cattlemen's Association 231

AMENDING THE AGRICULTURE AND FOOD ACT OF 1981

WEDNESDAY, OCTOBER 9, 1985

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 9 a.m., in room SD-538, Dirksen Senate Office Building, Senator Jake Garn (chairman of the committee) presiding.

Present: Senators Garn, D'Amato, Gorton, Mattingly, and Dixon.

Also present: Senator Mark Andrews, Representatives Charles W. Stenholm and Steve Gunderson.

OPENING REMARKS OF CHAIRMAN GARN

The CHAIRMAN. The Banking Committee will come to order.

The purpose of this morning's hearing is to consider the effect S. 744 would have on agricultural credit and on agricultural lenders.

We literally had dozens and dozens of people requesting to testify on this bill. We had to turn most of them down, although we still have 19 witnesses scheduled for this morning. Therefore, it will be a long agenda, particularly since we did not know at the time we scheduled the hearing that there would be a joint session. My apologies to Lee Kwan Yu. I do not intend to go to the joint session in deference to all of the witnesses who have been scheduled, many who have come from out of town. But time is at such a premium that I will say no more at this point and merely ask unanimous consent that my opening statement be placed in the record.

OPENING STATEMENT OF CHAIRMAN GARN

Good morning, and thanks to all of you for taking such an interest in a new issue for the Banking Committee. S. 744, was referred to this committee to consider what effect the bill might have on agricultural credit, and on agricultural lenders.

Because of the number of witnesses appearing before us today and because of the joint session, we have asked all the witnesses to be as concise and succinct as possible, and all oral statements will be limited to no more than 5 minutes. Full statements may be submitted for the record. We have had a number of people contact us to testify and we have limited the number of witnesses severely—otherwise, this hearing could go on for days. I appreciate the cooperation of all our witnesses with this time limit.

For the record, I would like to review what S. 744 does. Presently, under the Uniform Commercial Code [UCC], buyers of farm products can be liable to someone who has a security interest in farm products, even though the buyer has already paid the farmer the full purchase price, if the farmer has not paid off his loan. As the problem in the agricultural industry has intensified, buyers of farm products have found themselves defending lawsuits more frequently and have had to pay secured lenders, thus doubling the purchase price to them. The purchaser of farm products can protect himself by performing a search of the UCC records. This UCC search can be cumbersome, especially in those States where liens against farm products are recorded at the county level. S. 744 does continue the priority for perfected security interests if the lender gives written notice of its security interest to the buyer within the 12 months preceding the sale. Under S. 744, a buyer generally would take free of lien even if it has actual notice of the lien, but specific written notice is not provided.

Certainly, it is unfair for buyers of farm products to be required to pay for them twice. On the other hand, the National Grange has sent me a letter, which will be included in the record, that states that illegal conversion, which triggers this double liability for purchasers, is relatively infrequent. If so, is there any need for S. 744? In addition, I do not know what effect, if any, passage of S. 744 would have on agricultural lenders, who seem to be the key to the survival of the American farm community. Would the passage of S. 744 result in the wholesale classification of crop loans by the regulators, on the ground that they are no longer secured loans? Would S. 744 have any effect on credit availability for marginal farm operators? These seem to me to be the immediate, practical issues that should be addressed in this hearing.

However, there is another issue that is of great importance to me as well. That is that S. 744 would preempt the laws of at least 48 States. Now, 35 States still operate under the official text version of the UCC on this point, and 15 States have looked at this double liability problem, and have amended their laws. But the laws of these States, where the expertise in the area of commercial law really lays and knowledge of local agricultural practices exists, would be preempted.

[Copy of proposed bill S. 744 follows:]

II

99th CONGRESS
1st Session

S. 744

[Report No. 99–147]

To amend the Agriculture and Food Act of 1981 to provide protection for agricultural purchasers of farm products.

IN THE SENATE OF THE UNITED STATES

March 26 (legislative day, February 18), 1985

Mr. Cochran (for himself, Mr. Boren, Mr. Nickles, Mr. Bentsen, Mr. Harkin, Mr. McConnell, Mr. Andrews, Mr. Kasten, Mr. Wilson, Mr. DeConcini, Mr. Denton, and Mr. Gramm) introduced the following bill; which was read twice and referred to the Committee on Agriculture, Nutrition, and Forestry

October 3 (legislative day, September 30), 1985

Reported by Mr. Helms, with an amendment and an amendment to the title

[Strike out all after the enacting clause and insert the part printed in italic]

October 4 (legislative day, September 30), 1985

Ordered, referred to Committee on Banking, Housing, and Urban Affairs for a period not to extend beyond October 18, 1985

A BILL

To amend the Agriculture and Food Act of 1981 to provide protection for agricultural purchasers of farm products.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, ~~That (a) title XI of the Agriculture and Food Act of 1981 is~~

~~amended by adding at the end thereof a new section 1123 as follows:~~

~~"Sec. 1123. (a) Notwithstanding any provision of Federal, State, or local law, a buyer in the ordinary course of business who buys farm products from a seller engaged in farming operations shall take free of a security interest created by the seller even though the security interest is perfected and even though the buyer knows of its existence: *Provided, however,* That a buyer of farm products takes subject to a security interest created by the seller if: (i) within twelve months prior to the sale of the farm products the buyer has received from the secured party or the seller written notice of the security interest and of any payment obligations imposed on the buyer by the secured party as conditions for waiver or release of the security interest; and (ii) the buyer has failed to perform those obligations.~~

~~"(b) A commission merchant or selling agent who sells farm products for others shall not be liable to the holder of a security interest in such farm products, even though the security interest is perfected and even though the commission merchant or selling agent knew of its existence, if the sale is made in the ordinary course of business.~~

~~"(c) This section shall become effective thirty days after enactment, except that liens made prior to the effective date shall be exempt from the provisions of this section.".~~

That (a) for purposes of this Act:

(1) The term "buyer in the ordinary course of business" means a person who, in the ordinary course of business, buys farm products from a person engaged in farming operations.

(2) The term "commission merchant" means any person engaged in the business of receiving any farm product for sale, on commission, or for or on behalf of another person.

(3) The term "farm product" means a crop or livestock used or produced in farming operations, or a product of a crop or livestock in its unmanufactured state (such as ginned cotton, wool-clip, maple syrup, milk, and eggs), that is in the possession of a person engaged in farming operations.

(4) The term "knows" or "knowledge" means actual knowledge.

(5) The term "security interest" means an interest in farm products that secures payment or performance of an obligation.

(6) The term "selling agent" means any person, other than a commission merchant, who is engaged in the business of negotiating the sale and purchase of any farm product on behalf of a person engaged in farming operations.

(7) The term "State" means each of the 50 States, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the Virgin Islands of the United States, American Samoa, the Commonwealth of the Northern Mariana Islands, or the Trust Territory of the Pacific Islands.

(b) Except as provided in subsection (c) and notwithstanding any other provision of Federal, State, or local law, a buyer who in the ordinary course of business buys a farm product from a seller engaged in farming operations shall take free of a security interest created by the seller, even though—

(1) the security interest is perfected; and

(2) the buyer knows of the existence of such interest.

(c) A buyer of farm products takes subject to a security interest created by the seller if—

(1) within 12 months prior to the sale of the farm products, the buyer has received from the secured party or the seller written notice of—

(A) the security interest, including—

(i) the name and address of the secured party and the seller; and

(ii) a reasonable description of the property, including the jurisdiction in which the property is located; and

(B) any payment obligation imposed on the buyer by the secured party as a condition for the waiver or release of the security interest; and

(2) the buyer has failed to perform such obligation.

(d) Notwithstanding any other provision of Federal, State, or local law, a commission merchant or selling agent who in the ordinary course of business sells a farm product for another person shall not be liable to the holder of a security interest in such farm product, even though—

(1) the security interest is perfected; and

(2) the commission merchant or selling agent knew of the existence of such interest.

(e)(1) A security agreement in which a person engaged in farming operations creates a security interest in a farm product may require the person to furnish to the secured party a list of the buyers to whom the person engaged in farming operations may sell such farm product.

(2) If a security agreement contains a provision described in paragraph (1) and such person engaged in farming operations sells the farm product collateral to a buyer not

included on such list, the person engaged in farming operations shall be subject to paragraph (3) unless the person—

(A) has notified the secured party in writing of the identity of the buyer at least 7 days prior to such sale; or

(B) has accounted to the secured party for the proceeds of such sale not later than 10 days after such sale.

(3) A person violating paragraph (2) shall be fined not more than $5,000.

(f) This Act shall become effective 30 days after the date of enactment of this Act, except that a security interest attached prior to the effective date of this Act shall be exempt from this Act for 1 year.

Amend the title so as to read: "To provide protection for buyers of farm products.".

○

The CHAIRMAN. At this point, let me introduce our witnesses. This is going to be a lengthy hearing. First, my distinguished colleague from North Dakota, Senator Andrews, will make a statement, followed by Congressmen Stenholm and Gunderson. We are very glad to have you here today. I know that the House has passed a bill quite similar to S. 744, which was sponsored by Congressman Stenholm.

The next panel will include Marlin Jackson, Arkansas Banking Commissioner, and Kathleen Lawrence, Deputy Under Secretary for Small Community and Rural Development, USDA.

The third panel will give us the point of view of agricultural lenders on S. 744.

The fourth panel includes respresentatives of the purchasers of farm products.

Our fifth panel will give us the point of view of the producer himself.

I mentioned earlier that 15 States have addressed this issue and have amended their laws. I thought it would be useful to learn the State law mechanisms adopted by the State legislatures, and to hear the experience in those States since the new statutes were passed. On our sixth panel, we will hear about the Nebraska experience from Bill Brandt, general counsel of the Nebraska Bankers Association, and about what has been done in Minnesota from Dan Gunderson, executive director of the Minnesota Agri-Growth Council.

Gentlemen and Ms. Lawrence, thank you for coming. We look forward to receiving your testimony, but let me please reiterate my earlier request that you be brief.

Senator Andrews, would you like to begin, please.

STATEMENT OF MARK ANDREWS, U.S. SENATOR FROM THE STATE OF NORTH DAKOTA

Senator ANDREWS. I appreciate that, Mr. Chairman, and I appreciate the opportunity to testify before your committee on S. 744, which would eliminate the farm products exception from the Uniform Commercial Code. I am a cosponsor of this legislation. I am also the author of report language that would allow States the flexibility to design and implement a written prenotification system most suited to their individual needs and circumstances within the requirements of S. 744. As you know, the Senate Agriculture Committee approved both S. 744 and my report language.

Mr. Chairman, the principal objective of S. 744 is to correct the inequitable situation confronting buyers of agricultural commodities and to restore some level of uniformity in the treatment of liens filed on agricultural commodities. Against this must be balanced the legitimate interests of lenders who need assurance that the collateral on their loans is secured in more than name only. The application of penalties against those who illegally dispose of secured farm products is small, if any, protection for lenders.

I would like to submit my full statement for the record because I know your constrictions on time and I would like to make two points as strongly as I can, Mr. Chairman.

PROBLEM EXTENDS WELL BEYOND BUYERS AND LENDERS

This problem extends well beyond buyers and lenders. We are holding onto a three-legged stool here and I'd like to make sure that that third leg is adequately considered here. The American farmer will be directly affected by this legislation and at a time when our Nation is already facing severe farm credit problems we in Congress must make every effort to make sure that farmers do not suffer the consequences of legislation that would inadvertently impair their access to credit.

My second point is that many States, including my own, Mr. Chairman, have already adopted central notice systems or their equivalent to address this problem. As I mentioned before, I too support the need for uniformity in treating these liens, but I do not feel that Congress should mandate to the last detail the means by which the States approach this problem. I have long stood, as you have, for States rights and I strongly urge that this committee adopt language which I have included in my full statement that would allow States the flexibility to choose the precise form of written prenotification that is required by S. 744.

I represent a State, Mr. Chairman, that has just recently addressed this very problem. Our State legislature passed a law this year that introduces a central notification system that is designed to protect the interests of lenders and buyers alike. A wide cross section of North Dakota State banking and agricultural groups collaborated over several years to fashion this law. All of the following North Dakota groups supported this legislation in our 1985 legislative session: the Ag Coalition, Farmers Union, Farm Bureau, Stockmen's Association, Livestock Marketing Association, Bankers Association, Independent Community Banks, Association of Cooperatives, Grain Dealers Association, and Farm Credit Services.

Mr. Chairman, when you get this kind of broad agreement within your State it shows that they indeed have come up with the proper solution and I would hope that those kinds of solutions by the individual States would be allowed to stand.

I think in conclusion, Mr. Chairman, our State has an excellent law that meets the goals of S. 744 and should be allowed to stand within the guidelines of any Federal legislation. I think the amendment I'm offering represents a good compromise that will lend uniformity and protection to buying groups while still allowing individual States to choose a mechanism that will keep credit flowing between lenders and farmers in their own States.

Might I also point out, Mr. Chairman, that today on your agenda you will hear from Glenn Rogers, a farmer from Wahpeton. He will be presenting a view shared by the North Dakota Bankers Association and numerous farm groups. It shows that we have worked out in our State a problem that fits both the lenders and the borrowers and we plead with you to allow the freedom to operate that kind of a program in the individual States.

I appreciate your taking the time to hear my testimony and I would hope, Mr. Chairman, that my full statement would appear in the record as though I had given it in its entirety.

The CHAIRMAN. It certainly will, Mark. You will never have trouble from this Senator on giving States maximum flexibility.

Senator **Andrews**. I didn't think so, Mr. Chairman. I thought we were right on track.

The **Chairman**. I guarantee you that. Every time in the 11 years I've served on this committtee we have had any State override, whether it's usury or whatever we have been dealing with in the Banking Committee, there has always been a so-called Garn amendment that allows States, usually the period of time was 3 years, to override and tell the Congress of the United States to go to hell, to put it very bluntly.

Senator **Andrews**. That's right, Mr. Chairman, and in this case I have no pride of authorship. This doesn't have to be known as the Andrews amendment; it can be known as the Garn-Andrews amendment or just the Garn amendment, just so we get it in the bill.

The **Chairman**. Thank you very much and certainly your full statement will be in the record.

[The complete prepared statement follows:]

STATEMENT OF

SENATOR MARK ANDREWS

ON S.744
COMMITTEE ON BANKING, HOUSING & URBAN AFFAIRS
UNITED STATES SENATE
WEDNESDAY, OCTOBER 9, 1985

Mr. Chairman, I appreciate the opportunity to testify before this Committee on S.744, which would eliminate the "farm products exception" from the Uniform Commercial Code. I am a cosponsor of this legislation. I am also the author of report language that would allow states the flexibility to design and implement a written pre-notification system most suited to their individual needs and circumstances within the requirements of S.744. As you know, the Senate Agriculture Committee approved both S.744 and my report language.

Mr. Chairman, the principal objective of S. 744 is to correct the inequitable situation confronting buyers of agricultural commodities and to restore some level of uniformity in the treatment of liens filed on agricultural commodities. Against this must be balanced the legitimate interests of lenders who need assurance that the collateral on their loans is secured in more than name only. The application of penalties against those who illegally dispose of secured farm products is small, if any, protection for lenders.

Before submitting my full statement for the record, Mr. Chairman, I would like to make two points as strongly as I can. This problem extends well beyond buyers and lenders. We're holding onto a three-legged stool here and I'd like to make sure that that third leg is adequately considered here. The American farmer will be directly affected by this legislation. And at a time when this nation is already facing severe farm credit problems, we in Congress must make every effort to make sure that farmers do not suffer the consequences of legislation that would inadvertently impair their access to credit.

My second point is that many states, including my own, have already adopted central notice systems or their equivalent to address this problem. As I mentioned before, I too support the need for uniformity in treating these liens, but I do not feel that Congress should mandate to the last detail the means by which the states approach this problem. I have long stood for states' rights and strongly urge that this committee adopt language which I have included in my statement that would allow states the flexibility to choose the precise form of written pre-notification that is required by S. 744.

I represent a state, Mr. Chairman, that has just recently addressed this very problem. North Dakota's state legislature passed a law this year that introduces a central notification system that is designed to protect the interests of lenders and buyers alike. A wide cross section of North Dakota state banking and agricultural groups collaborated over several years to fashion this law. All of the following North Dakota groups supported this legislation in our 1985 Legislative Session: the Ag Coalition, Farmers Union, Farm Bureau, Stockmen's Association, Livestock Marketing Association, Bankers Association, Independent Community Banks, Association of Cooperatives, Grain Dealers Association and Farm Credit Services. I think it is an excellent law that meets the goals of S.744 and should be allowed to stand within the quidelines of any federal legislation. I think the amendment I am offering represents a good compromise that will lend uniformity and protection to buying groups while still allowing individual states to choose a mechanism that will keep credit flowing between lenders and farmers in their own states.

North Dakota Central Notice Law

North Dakota Senate Bill 2450 established a central notice system at the office of our Secretary of State. Lenders who want to put the farm product buyer on notice and hold him responsible for jointing the checks must file with this system. The Secretary of State will establish a cut-off date each month for those filings to be in. Then a list of mortgage and lien holders will be published and sent to farm product buyers. That list will be the final authority on mortgages and liens for a one month period. If the seller's name is on the list, the buyer must cut the check jointly to the lender(s) listed as holding a security interest in the products being sold, in order to buy free and clear. If the seller's name is not on the list the buyer takes free and clear. Lenders who make loans after the cut-off date will not have their names on the list until the first of the succeeding month.

For elevators and livestock markets this system means a single, dependable, up-to-date source of mortgage and lien information, specifically identifying products under security interest. For lenders it means a better way to put notice of their security interest in the hands of farm product buyers. For our rural communities it means protection for farmers and businesses from the dishonest acts of a few.

The North Dakota system is unique in separating the filing for 1)perfection of security interest and 2)establishing priority (both still remaining at the County Register of Deeds); from 3)giving notice to farm product buyers (Secretary of State central notice system). This means that lenders can fulfill all the legal filing requirements (County), while not having to inconvenience their borrower or the farm product buyer with joint checks unless they want to through the notice system (Secretary of State).

North Dakota's Secretary of State will serve as a clearing house for mortgage and lien information, assembling it from the various lender sources, and then distributing it out to buyers in an organized form. The list will be available on microfiche slides. Buyers will have a one-time expense of a $275 reader and a yearly $96 list subscription fee. Under the federal proposal North Dakota elevators will be exposed to a deluge of nonstandard notices from an almost unlimited number of sources. These notices will have to be cataloged somehow, filed, and then searched through at the time of each sale. This creates a filing system at each buyer's location, while in North Dakota we have assigned that responsibility to one place, with access available to all buyers.

Our system takes effect January 1, 1986 across-the-board. This means that existing security interests must be placed into the central notice system to hold buyers liable. The federal proposal provides that "liens made prior to the effective date shall be exempt...". This leaves buyers in a no-man's land, receiving notices on new liens and, until previous security interests expire, wondering whether they should check some place else for old liens.

Our central notice system covers supplier liens also, such as seed, chemical and fertilizer liens. In these cases our elevators often become the "lenders" and thereby benefit from the better notice to other farm product buyers. The federal proposal is silent on supplier liens.

Our system covers farmer to farmer transactions.

Our system provides for confidentiality of private personal financial information because no dollar amounts go into the central system. the federal proposal offers no such guarantees because "notice" is not defined.

Like the federal proposal, ours is a voluntary system. If lenders choose to not give notice then they can not impose liability on buyers. Buyers who choose to ignore the notice do so at their own risk. Like the federal proposal, our notice system will be paid for by users, not taxpayers.

North Dakota's law purposively does not use the term "central filing" to describe its method of pre-notification. We dislike the word "filing" because it may imply lenders taking their filing out of County offices and depositing them in a central system with buyers reponsible for obtaining the information by phone or letter. Similar systems of other states have resulted in a backlog of requests for information. The current list, in the hands of buyers, is the key. We prefer the word "notice".

Finally, Mr. Chairman, there is a great danger of delay and confusion if the federal proposal is enacted without specifically allowing our central notice system to serve as an acceptable pre-notification. Our North Dakota lenders and buyers will have to follow our state law; that's a given. But if lenders feel that in addition the federal law requires them to give direct notice, then I they will likely also adopt a direct notice procedure. This will be expensive and confusing for lenders and buyers, not to mention the legal implications of trying to follow just one system or the other and getting caught in the middle. North Dakota's state legislature will not meet again until January 1987.

I have included suggested amendment language that speaks to what I feel is the root of the problem between the federal proposal and our state law. The federal proposal requires direct notice from lender to buyer. Our system provides for "constructive" notice to a middle-man, from whom it is the buyer's responsibility to obtain the information. Our elevator men are willing to accept that responsibility as part of a three-legged stool---farmer, lender, buyer---to keep agricultural lending and marketing flowing smoothly. I think the attached language brings these two notice types into harmony.

I do not seek to prescribe that other states must adopt a system similar to ours, but I feel it is unreasonable for a federal clear title law to ignore and render invalid the fruitful collaboration of the groups I named at the start of my statement. I believe our central notice system should be specifically provided for in the federal law as an acceptable form of pre-notification under the Act and urge this Committee to accept the attached amendment language.

Suggested Amendment Language

The language drawn up below is intended to allow central notice systems to qualify as pre-notification:

> "If a state has enacted legislation which provides for written notice to be made under a central notification system which serves as "constructive notice" to buyers of agricultural commodities, it is also the intent of this legislation that notice given through such system constitutes written pre-notification under this Act."

The CHAIRMAN. Congressman Stenholm.

STATEMENT OF CHARLES W. STENHOLM, U.S. REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. STENHOLM. Thank you, Mr. Chairman. I too have a statement but I would ask that it be made a part of the record and I will summarize briefly my position on this important issue.

The CHAIRMAN. It will be.

POSITION OF HOUSE AGRICULTURE COMMITTEE

Mr. STENHOLM. Mr. Chairman, I would say that the testimony I submit and the record we have developed on the House Agriculture Committee in passing this legislation stems in the House, being a farmer, of serving on a bank board, as well as being a Member of Congress who has been dealing with this issue since 1983.

I believe the legislation that we have passed in the House meets the criteria that my good friend Senator Andrews has talked about so eloquently in his testimony. We all have the concerns of States rights but we also recognize that agriculture today is much different than it was 10, 20, 30, 40 years ago, and today we face a legitimate problem. I also serve on the Small Business Committee and find that the problems associated with the agricultural exemption is creating tremendous problems for many smaller businesses throughout this Nation. Therefore, we believe that the record that we have established in the House through the hearing process and again by the vote on the Agriculture Committee, when all of the arguments were made that you will hear today from the banking community and from others who are concerned about this change—the vote was 26 for the approach that has passed the House and 3 in opposition on the House Agriculture Committee.

As we have heard from those who are concerned about making the change at this time because of the tremendous credit problems in agriculture, it was our judgment—Mr. Gunderson and I who you will hear from in just a moment—that we should introduce compromised legislation. And we believe that the prenotification requirements satisfy the concerns of those in the banking community regarding this change at this time.

We believe that the language mentioned, which caused a vote of 26 to 3 in the House Agriculture Committee, meets those concerns.

As far as the States rights issue is concerned, I wish to point out that my State has just recently passed legislation that is already creating tremendous problems within the agricultural purchasing community. I don't know whether the Texas system will continue to be utilized or repealed. Regardless, there are tremendous concerns associated with an attempt to solve a problem with the magnitude of this particular issue and doing it on a State-by-State basis in which we could conceivably have 50 different State interpretations.

I would conclude by saying that the controversy surrounding this issue was very evident from the beginning. When I chose to take a forthright position on this legislation, I contacted each of the financial institutions within my district. I had a few that said: "We don't like it. It's terrible." But the overwhelming consensus, 90 percent plus, said: "Charlie, we can't quarrel with the intent of the legislation. It makes good sense. We wish you hadn't done it because we kind of like the way the status quo has been, but we cannot argue with the logic and fairness."

That's why we're here today, Mr. Chairman. We believe the legislation before you is fair and equitable, will meet the needs of the agricultural finance community, and the concerns of good-faith agricultural buyers.

I thank you for the opportunity to address your committee.

[The complete prepared statement follows:]

STATEMENT

OF

THE HONORABLE CHARLES W. STENHOLM
MEMBER OF CONGRESS

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

AS A RESULT OF THE DEPRESSED FARM INCOME SITUATION OF THE PAST FEW YEARS, AGRICULTURAL PRODUCTION LENDERS AND GOOD FAITH BUYERS OF FARM PRODUCTS HAVE INCREASINGLY FOUND THEMSELVES PITTED AGAINST ONE ANOTHER. FARM LENDERS HAVE BEEN PLACED IN FINANCIAL JEOPARDY BECAUSE SOME OF THEIR BORROWERS HAVE SOLD FARM PRODUCTS PLEDGED AS COLLATERAL WITHOUT APPLYING THE SALE PROCEEDS TO THEIR INDEBTEDNESS. BONA FIDE BUYERS OF FARM PRODUCTS HAVE HAD TO CONTEND WITH THE RISK OF PAYING TWICE FOR THEIR PURCHASES -- ONCE TO THE SELLER AND AGAIN TO THE LENDER WHO HELD A SECURITY INTEREST IN THE COMMODITY THEY PURCHASED DUE TO THE ANOMALOUS AND INEQUITABLE SITUATION CAUSED BY SECTION 9-307(1) OF THE UNIFORM COMMERCIAL CODE (U.C.C. OR CODE).

AS A GENERAL RULE, ARTICLE 9 OF THE U.C.C. FOSTERS AN OPEN MARKET RULE WHICH PERMITS GOOD FAITH PURCHASERS TO TAKE GOODS FREE AND CLEAR OF PERFECTED SECURITY INTERESTS. THIS GENERAL RULE DOES NOT, HOWEVER, HOLD TRUE FOR GOOD FAITH PURCHASERS OF FARM PRODUCTS. BY VIRTUE OF THE FARM PRODUCTS EXCEPTION, BUYERS OF FARM PRODUCTS MUST SEARCH FOR LIENS OR BEAR THE RISK OF HAVING TO PAY TWICE FOR THEIR FARM COMMODITY IF A LIEN EXISTS. IN EFFECT, THE BUYER OF FARM PRODUCTS BECOMES THE INVOLUNTARY GUARANTOR OF A LOAN ABOUT WHICH HE KNEW NOTHING, IN WHICH HE HAD NO INPUT AS TO THE ADVISABILITY OF THE LOAN OR THE LIMIT OF THE CREDIT GRANTED, AND FOR WHICH HE RECEIVES NO COMPENSATION IN THE FORM OF INTEREST TO COVER RISK EXPOSURE AND JEOPARDY HE HAS INVOLUNTARILY AND UNKNOWINGLY ASSUMED.

As the mortgaged farm products problem has grown, so has the concern of buyers and commission merchants. They have increasingly sought legislation to protect themselves and to unfetter the flow of agricultural commodities. Prior to 1983 only six states had enacted legislation specifically aimed at creating an equitable distribution of risk and responsibility among lenders, debtors, purchasers, and commission merchants alike. More recently, numerous states have modified, or are now involved in the long and complicated process of modifying, their commercial codes to address the problem. However, because of the disparate approaches used by the individual states the value of all this legislation is uncertain -- the U.C.C. has become even more anomalous. And this problem is particularly compounded as a result of the increasing utilization of interstate livestock and commodity markets.

Proponents of the farm products exemption continually argue that buyers of farm products can protect themselves from becoming sureties by checking lien records. However, in practice, the search of lien records that the U.C.C. would require of buyers is too time consuming to be practical. Even when records can be located, they often lack the information the buyer requires because the secured party is not required to update the information.

Buyers of livestock must also comply with the requirements of Section 228b of the Packers and Stockyards Act and similar state laws. Livestock buyers regulated by Section 228b are required to pay for livestock by the next business day after the sale is made. Because this is not enough time for buyers to check records, Section 228b and similar state laws have been dubbed the "pay and pray" laws.

QUESTIONS HAVE BEEN RAISED ABOUT WHETHER IT WOULD BE CONSISTENT WITH STATES' RIGHTS TO ENACT S. 744 (OR H.R. 1591 WHICH HAS BEEN INCORPORATED INTO SECTION 1314 OF H.R. 2100, THE FOOD SECURITY ACT OF 1985). WOULD THE VALUES ASSOCIATED WITH THE CONCEPT OF FEDERALISM BE IN ANY SIGNIFICANT WAY UNDERMINED OR CONTRAVENED BY PASSING FEDERAL LEGISLATION TO MODIFY THE FARM PRODUCTS EXCEPTION CONTAINED IN SECTION 9-307(1) OF THE UNIFORM COMMERCIAL CODE?

AMENDING A PORTION OF ONE SUBSECTION OF THE U.C.C. IN CONGRESS BY PLACING S. 744 ON THE STATUTE BOOKS IN ORDER TO VINDICATE IMPORTANT NATIONAL INTERESTS IN THE UNENCUMBERED INTERSTATE MARKETING OF CROPS AND LIVESTOCK WOULD HAVE NO ADVERSE IMPACT ON LEGITIMATE STATE CONCERNS. IT WOULD COMPORT MORE WITH THE CONSTITUTIONALLY AND POLITICALLY APPROPRIATE BALANCE OF POWER BETWEEN THE UNITED STATES AND THE SEVERAL STATES WITH RESPECT TO THE ELABORATION OF RULES GOVERNING THIS COUNTRY'S COMMERCIAL TRANSACTIONS THAN CONTINUATION OF THE CURRENT CACOPHONOUS STATE OF THE LAW.

S. 744 ADRESSESS AN ISSUE OF NATIONAL SCOPE THAT STATE-BY-STATE TINKERING HAS ONLY COMPLICATED AND CONFUSED TO THE POINT THAT THE CORE PURPOSES OF THE UNIFORM COMMERCIAL CODE -- SIMPLIFYING, CLARIFYING, AND MAKING UNIFORM THE LAW GOVERNING COMMERCIAL TRANSACTIONS, HAVE BECOME A CASUALTY OF GRANTING THE STATES SUCH LEEWAY. IT IS DUBIOUS INDEED THAT THE STATES SHOULD HAVE THE "RIGHT" TO CREATE SUCH INEFFICIENT DISUNIFORMITY AFFECTING COMMERCE. PRESERVING SUCH A STATUS QUO IS HARDLY WHY THE FRAMERS FIRST MET IN ANNAPOLIS "TO TAKE INTO CONSIDERATION THE TRADE OF THE UNITED STATES" AND RECONVENED TO PHILADELPHIA TO DRAFT THE CONSTITUTION.

Furthermore, the pace of preemption clearly has increased in the 1980's, be it of the Uniform Commercial Code or state laws on banking and consumer matters. Congress has become increasingly convinced, when confronted with the economic needs of all borrowers or lenders and sellers or buyers. that the abstract argument of states rights should yield, in selected instances, to the concrete force of national concerns.

The legislation contained within S. 744, effectively provides traditional protection and creation of equitable distribution of risk and responsibility among lenders, sellers, purchasers, and commission merchants alike by preempting the farm products exception of the U.C.C., yet providing a mechanism under which lenders may CHOOSE to protect their security interests through notice to potential buyers that a lien exists and what steps the buyer or commission merchant must legally take to satisfy that security interest. However, the bill does not prescribe the manner in which a lender must notify the buyer. This is to allow lenders the maximum flexibility to set up systems which best meet their individual needs.

During the legislative process support for S. 744 has grown. The coalition of national agricultural groups and state affiliates supporting "clear title" has ballooned from eight in 1983 to 28 today. This testifies to the severity of the double payment problem and the popularity and support of clear title legislation.

A further strong testimony to the wisdom and need of S. 744 was announced by the Federal government in the person of Secretary of Agriculture John Block which supports and favors this legislative solution because it will: "(1) treat farm products equally with all other products in this country; (2) allow consistency among and between States; (3) remove obstructions to free trade and orderly marketing; and (4) remove double payment risk from purchasers of farm products."

The **Chairman**. Thank you, Congressman. I don't think you can argue with the logic. People shouldn't have to pay for something twice. We can sum it up with that. But I do think that there is something to be looked at in terms of States rights, not just because I traditionally favor that. The comment you just made about not having a hodgepodge—that is always the other side of the coin of why we are smarter, why we have greater wisdom here, 535 of us, than individual States. I have always had a difficult time of, regardless of the issue—and I've been very consistent, even when it is something that I am very much for because it's logical and makes sense—crossing that line to tell the Utah Legislature and the Texas Legislature and the North Dakota and the Wisconsin Legislatures, that we're smarter than you are and we want to override you. That's a very fundamental belief and that's why I think we have to be careful when we do that.

Mr. **Stenholm**. I certainly agree with that, Senator.

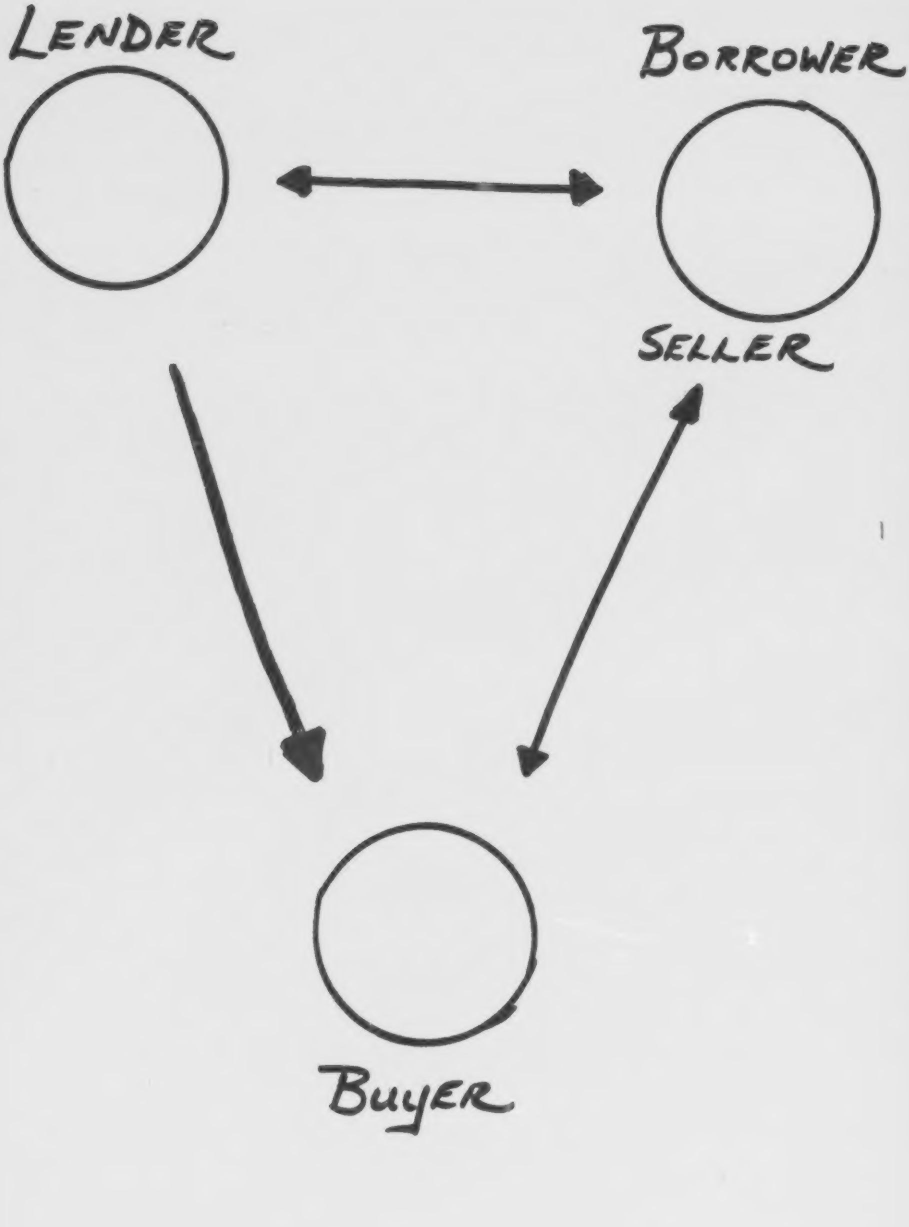
The **Chairman**. Congressman Gunderson.

STATEMENT OF STEVE GUNDERSON, U.S. REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

Mr. **Gunderson**. Thank you, Mr. Chairman and Senators. When I was told that we were to try to limit our remarks to 1½ minutes I decided that I would also ask unanimous consent that a written statement might be submitted for the record and, in the tandem approach that Congressman Stenholm and I have tried to take from the beginning in this effort, I want to very simply explain the logic of what I think we're doing.

When we were discussing this in the House Agriculture Committee I sat at my desk, made a little chart, and held it up. It seemed to work there and, so, I'm going to use a similar chart here this morning to explain exactly what we're talking about.

[Representative Gunderson's chart follows:]


LENDER
BORROWER
SELLER
BUYER

GIVE THE FARMER THE SAME PROTECTION AS ANYONE ELSE

Mr. GUNDERSON. You have the lender and you have the borrower. The borrower obviously gets the money from the financial institution. He grows the commodity, whether it be livestock, wheat, a feed grain or something else. He then becomes the seller and he sells it to the buyer. There is one transaction between the lender and the borrower. Once the borrower becomes the seller, there's a separate transaction between the seller and the buyer. The problem with the present law and the reason that S. 744 needs to pass is that, unless we pass this legislation, we will continue to allow the lender to go after an innocent third party—the buyer—for a contract between the lender and the borrower. That's the whole concept behind this legislation, to give the farmer in this country the same protection under the Uniform Commercial Code that we give every other American citizen and every other element in the conduct of business.

As Congressman Stenholm said, we have tried to go an extra mile here in terms of compromise by giving a notification requirement and place into the legislation a rather significant penalty of $5,000 if the farmer sells to someone who is not adequately notified.

So I think we do try to deal with that.

PROBLEM OF MULTISTATE LAWS

One other thing I want to share with you in terms of the problems with dealing with this on just a State-by-State basis, some 20 States have tried to deal with this in separate legislation at the present time. And I call to your attention a situation that occurs in my district in southwestern Wisconsin. Many of my farmers in that area happen to sell to the livestock processors in Dubuque, IA. Dubuque, IA purchases livestock from farmers in Iowa, Illinois, Wisconsin, and Minnesota. You can quickly see the problem any one of those purchasers or those processors are going to have if you have four different State laws and you also have, as we do at the present time, a 24-hour turnaround requirement from the time they purchase that livestock to submit a check to the seller or to the farmer. That's the incentive behind this.

I think with that, Mr. Chairman, I will complete my remarks.

[The complete prepared statement follows:]

STEVE GUNDERSON
3D DISTRICT WISCONSIN

MEMBER
AGRICULTURE COMMITTEE
EDUCATION AND LABOR
COMMITTEE

Congress of the United States
House of Representatives
Washington, DC 20515

227 CANNON HOUSE OFFICE BUILDING
WASHINGTON DC 20515
202-225-5506

DISTRICT OFFICE
P.O. BOX 247
438 NORTH WATER STREET
BLACK RIVER FALLS, WI 54615
1-800-472-6612
715-284-7431

PREPARED STATEMENT OF
THE HONORABLE STEVE GUNDERSON, M.C., OF WISCONSIN
BEFORE THE
SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
OCTOBER 9, 1985

MR. CHAIRMAN:

I would first like to thank the Chairman for the opportunity to address this most distinguished panel on an matter of paramount importance to our agricultural community, the issue of "clear title". I am particularly pleased to join with my good friend and colleague from Texas, Congressman Charlie Stenholm, in asking the Committee to consider adopting Federal Clear Title legislation.

The question facing this Committee and the Congress as a whole is one of fairness and consistency. Under existing inconsistent state laws regulating the rights of purchasers of agricultural commodities, very inequitable results occur.

As orginally drafted and adopted by 49 of the 50 states, §9-307 of the Uniform Commercial Code permitted a buyer of goods (except for farm products) in the ordinary course of his business to take those goods free and clear of any security interest created by his seller even though that security interest is perfected and even though the buyer knew of its existence. The so-called "farm products exception" has made purchasers of agricultural commodities, unlike the buyers of other goods, the effective guarantors of the debts of the sellers which are secured by those commodities.

That status is inequitable for at least two reasons. First, with the advent of 24-hour payment regulations for some farm products, such as livestock, there simply is inadequate time to check for outstanding liens in all cases. Many times, the result for buyers is a double payment for agricultural commodities--once to the seller and once to the lender.

Secondly, there is no effective time limitation on this guarantor relationship. I am told that in my own state of Wisconsin, we have had a case where, several years after the purchases occurred, a financial institution with a broad-based security agreement sued under the farm products exception and collected many months of milk checks made by a small cheese plant to its its borrower/dairy farmer. The bank could have requested a monthly check-off. Instead, it waited until the farmer was in bankruptcy to claim its payment from the purchaser. Now, there are two small businesses in bankruptcy.

Recognizing this inequity, more and more states are backing out of the farm products exception. In fact, I understand that 20 states have now adopted different methods of addressing this issue. Of course, that means that the Uniform Commercial Code is anything but uniform on this subject.

This inconsistency and lack of legal certainty has an adverse impact on the free-flow-of-commerce in the United States as well since farmers and processors, alike, must adjust to a different set of rules and regulations for each jurisdiction. It's not surprising to find out that some have simply reverted to intrastate operations. Clearly, the stage is set for a single, Federal rule governing the purchase and sale of agricultural commodities in the United States.

Accordingly, Congressman Stenholm and I introduced H.R. 1591 earlier this year on the House side. As you would expect, it has gone through several refinements before becoming §1314 of H.R. 2100, the House version of the 1985 Farm Bill.

Basically, our proposal would treat buyers of farm products in the ordinary course of their business the same as purchasers of other goods by granting them clear title to the products upon their purchase. However, because agricultural lenders have come to rely on the farm products exception over time, we include an exception to clear title to fully protect these lenders should they choose to elect such protection.

Specifically, a buyer of farm products will not take clear title to those commodities if, within the last 12 months, he has received written notice of a security interest in those goods and any payment obligations with respect to the farm products and, then, fails to meet those payment obligations.

A fine of not more than $5,000 is provided for a farmer/borrower who furnishes a list of potential buyers to his lender and, then, sells to someone else without accounting to the lender for the proceeds of the sale within 10 days of that sale.

Mr. Chairman, our proposal would eliminate the inequities and inconsistencies of the present patchwork of State rules in this area of the law. At the same time, it places the burden of enforcing the financial relationship between lender and borrower where it belongs--on the parties to that relationship, not on an innocent purchaser of farm products unless, of course, that purchaser has written notice of the existence of that relationship.

I recognize that there are members of the financial community who do not support Federal action in this area and, specifically, the legislative proposal we present to you today. From the beginning, I have told these individuals and organizations that we intend to work with them on this issue. The fact that the change included in H.R. 2100 is not a "pure" clear title bill (like that which was offered last year) and contains an exception based on written notice is proof of our willingness to work toward a common solution.

Similarly, Mr. Chairman, I make a similar pledge to work with you and all of your colleagues to produce an effective resolution of this matter. Again, thank you for the opportunity to address the Committee on this important issue. I look forward to working with all of you in the upcoming months.

Steve Gunderson

The CHAIRMAN. Thank you very much. And whatever else we have proved with this testimony this morning, I think it is notable and may be historic that three Members of Congress have concluded their testimony in less than 15 minutes. I thank all three of you for coming this morning.

At this point I would ask that a statement by Senator Heflin be inserted in the record.

STATEMENT OF SENATOR HOWELL HEFLIN

Senator HEFLIN. Mr. Chairman, I certainly appreciate the opportunity to present my views on S. 744 to the Committee on Banking, Housing, and Urban Affairs.

S. 744 amends the Agriculture and Food Act of 1971 by adding a new section providing Federal preemption of the "farm products exception" of the Uniform Commercial Code, UCC 9-307(1) (1977). The UCC is a model State law enacted by every State except Louisiana. The "farm products exception" is currently the law in the vast majority of jurisdictions. Thirty-eight States currently have either the UCC official text of 9-307(1) or its functional equivalent. Eleven States have altered the notice provisions involved. But only two States, California and Tennessee, have eliminated the "farm products exceptions," and Tennessee's deletion is limited.

The regulation of commercial transactions has traditionally been the province of the States. One of the primary purposes in enacting the Uniform Commercial Code was to assure that the States retain control of regulating the basic commercial law of the country while fostering uniformity. Repeal of the "farm products exception" would certainly not further this goal.

The UCC was designated to be State-enacted to allow for local variations addressing the concerns of each individual State while following the basic guidelines of the UCC. The States currently regulate the vast majority of commercial and business transactions through their versions of the UCC which they are free to alter to fit their particular circumstances. Congress need not interfere with this regulation. Not all provisions of the UCC are identical in every State. If total uniformity is desirable, then Congress should not consider piecemeal preemption of various sections. Deletion of one provisions will not accomplish uniformity. A review of the adverse effects of State variation of the UCC should be complete and should begin with the Permanent Editorial Board of the UCC. It is for the Board to study the problems inherent in the system and on the basis of its findings, to make recommendations as to whether particular provisions such as the "farm products exception" are in need of revision. The Board reviewed the "farm products exception" as recently as 1978 and decided at that time that its retention was necessary.

The problems in the agricultural area extend beyond section 9-301(1). The troubles faced by those involved in agriculture financing today are complex. They warrant careful examination and study. Precipitous elimination of the "farm products exceptions" by S. 744 is inimical to a thorough review of the agricultural financing system as a whole. Enactment of S. 744 exacerbates the problems in agriculture and agricultural financing.

The problems arising in the area of agricultural secured lending, no less than in other areas of commercial transactions, are best handled at the State level through traditional means of State regulation. States are free to tailor the UCC to their particular needs and many States have reviewed and adopted versions of the "farm products exception" which are satisfactory to them.

States should be able to retain their right to adopt and modify the UCC. S. 744 preempts that right and sets an undesirable Federal precedent. S. 744 clearly frustrates the right of States to regulate their business and commercial transactions, and for this reason, I oppose its enactment.

The CHAIRMAN. I'd like to call to the witness table Marlin Jackson and Kathleen Lawrence.

Before I recognize you, Senator Mattingly has come to the hearing and I'd like to recognize him for any remarks he would like to make.

OPENING REMARKS OF SENATOR MATTINGLY

Senator MATTINGLY. Thank you, Mr. Chairman. I'd just like to commend you for calling this hearing on the Farm Products Purchasers Protection Act as amended by the Agriculture Committee.

I think it presents an interesting response to a contentious and complicated problem. I'm not sure what changes, if any, are necessary in the legislation to address adequately and effectively the issue before us. In any event, the purpose of the hearing is to get input from all sides.

I would like however, to take this opportunity to welcome before the committee Mr. Marion Luckey, Jr., from Harlem, GA. He will be testifying on your fourth panel, representing the views of pecan processors.

Thank you very much for the hearing.

The CHAIRMAN. Thank you, Senator.

Once again, let me apologize to all of the witnesses. It was a very difficult process to cover the spectrum of every side of the argument that we could and do it with 19 witnesses. I don't know that we have ever requested witnesses where we have had so many people that were eager to testify.

As a result, it is obvious that we will not have time to ask a lot of questions of each of the panels and so what we would like to do—and at this time I would request that each witness have a representative come to room SD-534, which is one of the Banking Committee rooms adjacent to this, between 5 and 6 p.m. today to pick up questions that we would like to have answered in writing.

And we would like also, because of the Senate schedule and desire to act on this bill as promptly as we can, to have those answers back to the committee by the close of business on Friday of this week.

Ms. Lawrence, would you like to begin, please?

STATEMENT OF KATHLEEN LAWRENCE, DEPUTY UNDER SECRETARY FOR SMALL COMMUNITY AND RURAL DEVELOPMENT, U.S. DEPARTMENT OF AGRICULTURE

Ms. **Lawrence**. Thank you, Mr. Chairman.

Mr. Chairman and Members of the Committee, I appreciate the opportunity to be with you today and to comment on legislation to provide protection for purchasers of farm products.

The legislation under consideration, which would supersede the farm products exemption of Section 9-307 of the Uniform Commercial Code, provides protection to commission merchants or selling agents, and provides a pre-notification mechanism under which lenders protect their security interests in certain farm products sold in the ordinary course of business.

The Department of Agriculture favors this legislation because it will:

1. Treat farm products equally with all other products in this country.

2. Allow consistency among and between States.

3. Remove obstructions to free trade and orderly marketing.

4. Remove "double payment" risk from purchasers of farm products.

Section 9-307 of the Uniform Commercial Code provides: "A buyer in the ordinary course of business, *other than a person buying farm products from a person engaged in farming operations,* takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence." (Emphasis added.)

Ordinarily, purchasers do not need to consider whether security interests cover the goods they purchase. Shoppers do not need to worry whether a department store has liens on its goods, nor do retailers need to check whether wholesalers have encumbered their equipment. Even if buyers know the goods they purchase are collateral for a loan, they take free of any security interest.

Only agricultural buyers run the risk of having to pay twice for their purchases, even if they do not have actual knowledge about the existence of a loan.

Now, let me discuss briefly the unique problem that arises due to the farm products exemption. Customarily, the sale of farm products by persons engaged in farming operations is conducted on very short notice. For example, livestock ranchers usually sell their cattle at auction. This leaves little time for the auctioneer or the purchaser to conduct a lien search on the cattle offered for sale. This problem is aggravated by the fact that most States require filing of financial statements covering farm products only in the county of the products' locale in most states, or in the county of the debtor's residence. Thus, because there is no central filing location, the auctioneer or the purchaser would be required to perform a county-by-county lien search to assure that the products are free of liens.

The fast-paced nature of the transaction makes such lien searches practically impossible; thus, auctioneers and purchasers must rely on the seller's representation that the livestock is not subject to a security interest. Sometimes, however, the auctioneers and purchasers subsequently learn that the livestock was encumbered and find themselves liable to the secured party.

If a seller/debtor defaults on the loan, or fails to account for the proceeds, the purchaser or commission merchant can be forced to pay twice for the goods, once at the time of the sale and again months or years later when the lender sues the purchaser or commission merchant for conversion of collateral. Recourse against the original seller frequently is unavailing. This problem is especially troublesome for livestock auction barns since the Packers and Stockyards Act requires cash buyers of livestock to pay for their purchases within one day of the sale transaction, and, as a practical mastter, the buyer may be difficult to trace.

As a result, several States have taken legislative action to remedy this situation. Each approach, however, is somewhat different with no clear consistency among States, leaving purchasers of goods shipped interstate subject to different laws, depending on the state of purchase.

The Uniform Commercial Code exists as the outstanding example of interstate cooperation, without involvement of the Federal Government. The Reagan Administration maintains a high regard for the concept of federalism, and actions pre-empting the authority of the States should be weighed with utmost care.

Furthermore, it is the Department's desire to act in harmony with the State law system to the maximum extent feasible, but with the recognition that State action alone is insufficient to satisfactorily resolve a national problem directly affecting interstate commerce. The effect of the bill is only to treat farm products in the same manner as any other products under the Uniform Commercial Code and to relieve commission merchants and selling agents of liability.

The interests of creditors must be protected, both in the interest of equity and to assure the availability of agricultural financing. Both private and Government lenders are rightfully concerned that their security interest be protected.

Conversion is punishable under State and Federal law. The proposed legislation would not disturb State penalties for conversion nor would it prevent States from altering those penalties in the future.

Therefore, the legislation's proposed mechanism for lien notification provides a method for the lender to protect the security interest in certain farm products. The pre-notification mechanism also allows lenders flexibility to establish systems which best meet their individual needs. The clear title proposal equitably resolves the problems of agricultural lenders, borrowers and product purchasers.

In addition, we believe it would have no impact on the Department's lending programs and would not affect the availability of farm credit. Statutes similar to the Federal proposal have been in force, successfully, in Illinois, Ohio, Indiana, Kentucky, Tennessee and California.

Conversions of collateral are relatively infrequent and, in cases where they have occurred and recovery has been attempted, the cost oflitigation has almost equaled the loss. For example, a survey by the Farmers Home Administration showed that the Agency, in 1984, collected $1.4 million in 130 separate lawsuits, hardly justifying the cost of litigation.

Thank you.

The **Chairman**. Thank you very much.

Mr. Jackson.

STATEMENT OF MARLIN D. JACKSON, BANKING COMMISSIONER FOR THE STATE OF ARKANSAS

Mr. **Jackson**. Mr. Chairman, ladies and gentlemen, it is an honor for me as predominantly a farmer or country banker from Paragould, AR, who is temporarily doing penance for the sins of farming and being a country banker by serving as bank commissioner for 193 State-chartered institutions in Arkansas.

NO NEED FOR FEDERAL INTRUSION

I have attempted, Mr. Chairman, to address the issues as outlined in your letter, looking first at the extent of the problem. In my 30 years of active farming, 25 years of agricultural banking, I only know of five or six instances where lien rights became a matter of dispute. In half of those instances, the merchant, the meatpacker, the grain buyer, prevailed in the dispute. So the truth is, Mr. Chairman, that there is no occasion for the Federal Government to intrude into the legitimate affairs of agriculture and agricultural business in the State of Arkansas or the other 49 sovereign States of this Union.

These State laws affecting lien rights on agricultural commodities are really no different than the lien rights on real estate, automobiles, stocks or bonds, or anything else. And to assume that the purchaser of livestock has no opportunity to search for liens is an absurdity. Farmers and ranchers do not materialize overnight brought into existence by the tooth fairy. They exist over long periods of time and I know of not one single instance in all of these disputes where there's been any loss on the part of a packer or grain merchant where any search for lien was made.

The fact is that the international grain barons, the mammoth poultry processors, and meat processors are simply attempting to transfer the normal risk of their business. They talk about being innocent third parties. They are no more innocent than any other person that's in business for a profit. They are simply attempting to transfer the normal risk from the international grain barons of this country to the community banks, the PCA's, the Farm Credit System, the FHA, and the Commodity Credit Corporation.

I was asked to address the issue of the availability of credit. I think if you read the Wall Street Journal—we get it a few days late in Arkansas so we're getting March editions now—we just now learned that the Farm Credit System is floundering on the shoals of bankruptcy, the largest farm lender in this country. Farm banks, agricultural banks, are closing at a rate almost of two a week in this country.

Now given those circumstances, one does not have to be a genius, a bank commissioner, or even a U.S. Senator to figure out that anything that increased the risk of extending credit to farmers and ranchers is going to exponentially decrease the availability of credit.

As the banking commissioner in Arkansas, I am required to put my hand on the Bible and take an oath that says that I will do my duty to my God and my country to ensure the safety and soundness and public confidence in the banking system. I predict that if this law is passed in its present form that whoever the banking commissioner is that takes that oath in solemnity will have no choice but to order the 193 institutions in Arkansas to avoid extending credit where a significant portion of repayment is predicated on liens on crops or livestock that can be frustrated or estopped by simply taking the commodity to the market.

Then the Uniform Commercial Code is not uniform. It is the outgrowth of the English common law. It took 200 years of hammering out a system to accommodate trades where there was a delicate balance between the creditor and the borrower and the merchant. Only the greed of international grain barons and the mammoth poultry and meat processors now drive this legislation in an attempt to move the risks from the normal risk of doing business in that arena into the capital accounts of the bank.

EFFECTS ON LOAN CLASSIFICATIONS

I was asked to address by a letter from you the impact of this legislation on loan classifications or loans that are accorded unbankable status by a bank examiner. Loan classifications through the farm banks are increasing at alarming rates. In Arkansas, they're going up from 300 to 400 percent. In many States they are going up from 500 to 1,000 percent increase in substandard, doubtful, and loss classifications.

Without fear of contradiction from anyone who has any knowledge of the subject, the enactment of this bill will greater exacerbate that problem. Loan classifications predictably will go up. But even worse, Mr. Chairman, those banks that are hanging on with their customers who are hanging on will have to withdraw from the extension of credit. They just can't afford any extra modicum of risk.

Now what we're talking about is the transfer of risk, not the elimination of risk. We're talking about one-half of 1 percent, a few unethical people who sell their products and sometimes in concert with the buyer, the merchant, sometimes without the merchant's knowledge, and fail to pay their just debts. No one can come before you and honestly and truthfully tell you they have had any enormous losses.

In Arkansas last year, through the default of one auction barn, a half dozen of our small country banks, the largest of which was under $20 million, suffered $1 million collective loss. The greater portion of these losses, Mr. Chairman, in fact occurred by the community agricultural banks, by the PCA's, and the FHA's. If you need to do anything, you need to strengthen the provision in the lien rights that protect the people that finance this high-risk thing called agriculture.

The exemption for agricultural products was placed in the Uniform Commercial Code for a very good reason. A typical loan in Arkansas for $300,000, about half of that would be predicated on current loan values of fixed assets—tractors, combines, tillage implements; $150,000 of that $300,000 loan is predicated almost entirely at the first part of the loan on crops that aren't even planted, on livestock that may not even have been born, and then as the season progresses it changes into growing crops and growing livestock and ultimately it's marketed. There is already in every State a wide array of notification process. To increase the notification process predictably will not bring any relief to anybody and results only in chaos.

Those States that have attempted this have found that it produces an avalanche of paper debris that is tantamount to grinding the grain merchants, the meat packers in huge piles of bovine feces. It's nothing more than just dumping a whole bunch of biodegradable material generated by word processors in order to protect the legitimate lien rights of people that are financing the highest risk segment of the economy in America today.

I would ask that my remarks that have been prepared and delivered to your staff be included as a part of the record.

[The complete prepared statement follows:]

PREPARED STATEMENT OF MARLIN D. JACKSON, BANKING COMMISSIONER FOR THE STATE OF ARKANSAS

Mr. Chairman, distinguished members of the committee, ladies and gentlemen. It is indeed an honor for me to appear before your committee and present my views concerning Senate bill 744 and the so-called "clear title" issue.

A copy of my resume is attached, which will give you an insight into my academic and work experience.

The testimony that I offer today is flavored with an array of prejudices. Admittedly, most of the prejudice arises out of my 25 years of experience as a country banker. During this period of time, I was very much involved in financing farmers and ranchers.

I have the honor of serving not only as bank commissioner for Arkansas but also as a member of the board of directors and a spokesman for the Agricultural Banking Institute, an organization much interested in preserving the ability of agriculture/community banks to serve their customers' credit needs. Admittedly, under the most ideal circumstances, it is challenging to serve this constituency. All of you are aware of the farm credit crisis. In the midst of this crisis bankers find it very challenging in their attempt to provide loans to finance crops and livestock. Indeed, bankers are employing greater initiative and imagination and incurring historical high risk in financing agriculture.

Since April 15, 1983, I have had the honor of serving as bank commissioner for the State of Arkansas. As such, I have supervisory and regulatory authority over 185 State-chartered banks, 3 industrial loan institutions and 4 trust companies. These State-chartered entities have deposits entrusted to them by their constituents of approximately $8 billion.

The banks, over which I have supervisory and regualtory responsbility for safety, soundness and public confidence, are predominately community banks that are extensively involved in financing farmers and ranchers.

As bank commissioner, I am an active member and have long been an associate member of the conference of the State bank supervisors, an organization that has a vital interest in any intrusion that inhibits the ability of the States to control their destiny and legislate appropriate laws with regard to banking and agriculture, including the Uniform Commercial Code which is the subject of discussion today.

I think it appropriate to address the questions: "Is there really a problem?" or "is this simply an effort on the part of the grain barons and giant poultry and meat processing companies to transfer portions of their normal risk of doing business from their segment of the agricultural economy to the capital accounts of the banks, PCAs, the Farmers Home Administration and the Commodity Credit Corporation?".

Predicated upon my 25 years of heavy experience in financing farmers and ranchers, I am convinced that there is no urgent need for any type of change or relief with regard to the "exception for agricultural commodities". In my 25 years of experience, I have only had 3 or 4 occasions in which lien-rights became matters of dispute. At least half of these occasions, the bank was unable to prevail in the dispute, because of technicalities or because the bank had failed to make "full and adequate disclosure", appropriate filings, or was found deficient by some other means by the courts.

Interestingly enough, in other instances the "purchasers of agricultural products" readily admitted that they were aware of the banks' liens and voluntary rendered payment. No doubt they sought restitution and to the best of my knowedge, obtained it from the farmers and ranchers from whom they had made their purchases.

A review of the cases tried in Arkansas, involving dispute of the collaterialized lender versus the "purchasers of agricultural products", one finds that the number of cases litigated is few and far between.

Based upon my quarter of a century of "real world experience", I am convinced that there is no urgent need and no cases made for a Federal override or a Federal intrusion into the Uniform Commercial Code of the various States, including the State of Arkansas.

For the past 35 years I have been actively engaged in farming operations in addition to my banking activities. My own experience in marketing my cotton, rice, soybeans, milo, and livestock reveals that there is no great inconvenience to the farm producer in having checks made jointly so as to protect the interest of the "protected lienholder", that is, bank, PCA or other creditor. As a farmer, I have not experienced any inconvenience, difficulty in marketing or embarrassment when asked by the purchasers of grain or livestock if liens exist and if so, to whom the joint payee of the check should be.

My own survey of purchasers of agricultural commodities indicates that most such purchasers have experienced very few instances where they have been called upon to make payment to the "perfected security interest" of the collaterialized lenders. In those rare instances where they have been called upon to do so, they readily admit they made no effort whatsoever to check the lien records of either the county or the State to determine the existence of liens.

The fact is, for the past 100 years the various States have relied heavily upon the "honor system" in which the purchasers of agricultural commodities and livestock have depended upon the honesty and integrity of the farm borrowers to utilize the proceeds from the sale of their commodities or livestock in appropriate payments of their debts. Admittedly, in times of extreme economic distress, such as the farm depression that is occurring now, the incident of breakdown in the "honor system" has increased somwhat. There is an old "burnt hill" saying: "In desperate times good men can and do sometimes become desperadoes."

The Uniform Commercial Code's predecessor, the chattel mortgage, dates back to the English common law. The exception made for "agricultural commodities and livestock" was made for very sound and valid reasons. Simply stated, agricultural products were exempt, because of the high risk involved in the financing of agriculture. This high risk, coupled with the mobility and the perishability of agricultural commodities, was the basis for most of the States making an exemption in their commercial code to the "clear title" provision of the Uniform Commercial Code.

The typical soybean, rice, milo, or wheat loan in northeast Arkansas is structured so that perhaps two-thirds of the amount of debt is covered by a lien on equipment, livestock, storage facilities or other fixed assets. The remaining one-third is predicated almost entirely upon the crop to be produced.

An illustration would be a $300,000 loan. The current market value of tractors, combines, tillage implements and other fixed assets might be equal to $200,000 with perhaps a loan value of $150,000. This leaves the remaining balance of $150,000 unsecured, except for the lien-rights on the crop first to be planted, later growing, hopefully harvested, and marketed—hopefully at a profit.

Obviously, any change in the "exception for agricultural products" that removes the exemption would increase the risk exponentially.

Because of the credit crisis confronting the American farmer, a great many farmers are having great difficulty in obtaining credit on any basis. Anything that increases the risk will significantly reduce the farmers' ability to obtain adequate credit. Under the present law and with the benefit of the provision in the law "that the lien follows the collateral", a great many farmers are unable to obtain adequate financing.

There is no doubt that the enactment of Senate bill 744 will have a very negative effect and will seriously reduce the availability of credit for farmers and ranchers.

As bank commissionor, it is my responsibility to regularly and routinely examining the 193 State-chartered financial institutions to ensure safety and soundness.

In making these examinations, a fundamental part of the examination—indeed the heart of the examining process—is a review and evaluation of the assets, that is, loans, bonds, and securities.

Without fear of contradiction, I assure you and members of the United States Congress that loan classifications will significantly increase, if Senate bill 744 is passed in its present form.

One does not have to be an expert in bank examination to realize that in times of extraordinary economic distress, marginal collateralized loans and loans with marginal cash flows will deteriorate and will be viewed as having "excessive risk", if Federal law is changed so that protection under the lien-rights is decreased. There is an absolute certainty that classified loans will increase dramatically.

In the 2½ years that I have been bank commissioner I have observed an increase between 300 and 400 percent in the dollar amounts and an even greater percentage in the number of classified loans among the banks that serve predominately agricultural customer-base. Obviously, if the lien-rights to crops and livestock are effectively cut off or estopped by Federal law, there will be an increase in classified loans.

As bank commissioner, I am gravely apprehensive that I would be compelled under the law to advise the banks under my supervision to avoid making loans where significant reliance for repayment of the loan is predicated upon the proceeds from the sale of commodities and livestock, if any law is passed so as to "estop" or cancel the lien-rights and thus significantly increase the risk of these loans. It is my considered opinion that banks engaging in such lending, wherein lien-rights are frustrated or estopped as a part of the marketing process, would indeed be engaging in "unsafe and unsound banking practices". As bank commissioner, I have no alternative but to insist that banks refrain from engaging in unsafe and unsound banking practices. Predictably, the enactment of Senate bill 744 would relegate many loans that are presently extended by bankers to their farmer and rancher customers from acceptable risk into the realm of "unsafe and unsound" lending practices.

In those few States that have modified or altered the "exemption for agricultural products" in their Uniform Commercial Code the results have been "massive chaos". One such State is the State of Iowa. It is my understanding that in Iowa, in order to perfect lien-rights of creditors, notification must be made to market points within broad geographic territories. This notification process has resulted in a generation of an avalanche of letters of notifications from banks, PCAs and others seeking to perfect their lien-rights.

In my home town of Paragould, Arkansas, the bank I was associated with for 15 years was significantly involved in the financing of row crops and livestock enterprises. In addition to filing the appropriate notices with the county clerk or with the clerk and the secretary of state, it was/is a common practice for this bank to provide a list of farmers who are indebted to the bank, and against which the bank holds a protected lien interest on their crops and livestock to all prospective purchasers. I assure you that this was not a simple, inexpensive or easy task. The list had to be mailed to prospective purchasers in one-third of southeast Missouri, portions of southwest Kentucky, one-fourth of the western part of Tennessee (particularly Memphis), northeast Mississippi and substantially all of Arkansas. Even with this practice, there were a few occasions where the bank stood losses because of unscrupulous farmers or ranchers who marketed their crops without requiring the checks to be issued jointly and who disposed of the proceeds without paying their debts.

Based on my own personal experience of providing lists to prospective purchasers, I assure you that those who seek removal of the "exemption" and who support the "clear title" bill will be most unhappy with any direct notification process. A provision requiring direct notification of prospective purchasers is impractical because the purchasers are not always known to the bank or other lienholder and cover a wide geographic territory.

Direct notification will predictably result in the grain merchants, poultry and meat processors being "smothered" in an avalanche of letters and lists as banks, PCAs, FHA and others seek to minimize their risk and perfect their lien.

In recent years, as the customers have become economically distressed, we have in one or two instances where customers haul their commodities outside the trade territory so as to avoid disposing their products at a market point where their name is likely to appear on a list. I share this information with you to indicate that the community banks are genuinely concerned about this problem and are willing to cooperate.

I am of the opinion that the most viable alternative to Senate bill 744 is a severe civil and criminal penalty for individuals who market crops or livestock without requiring the purchaser to issue the settlement checks jointly to the producer and the lienholder.

I am of the opinion that agricultural bankers, production credit associations, Farmers Home Administration and others involved in the financing of the crops and livestock are willing to cooperate in any practical and meaningful solution to the problem. If central filing, such as filing with the secretary of the State, is an improvement over the present system, I am confident that the providers of credit would cooperate in a central filing arrangement. However, I should point out that there does not appear to be any distinct advantage in filing at the State capitols versus the present system in most States of filing with the county seat.

While I have grave doubts to any significant improvement over the present situation, certainly banks, productions credit associations and others who regularly provide production loans would be cooperative in a "central filing procedure". Obviously, each individual State should designate with whom and the process under which central filing should occur.

The mortgages on homes, farms, automobiles and lien-rights on livestock, farm commodities are a legitimate matter of State government. The provisions of Senate bill 744 and similar provisions are an unwarranted intrusion of the Federal Government into State laws. While there are great variances among the 50 States in the "commercial code", it represents significant improvements over the preexisting "chattel mortgage" laws of a few years ago.

There is no occasion and there is no justification for the Federal Government to impose its will upon the States by altering the "Uniform Commercial Code", as adopted by the legislative branches and signed into law by the administrative branches, i.e., Governors of the various States.

In summary, based on more than 30 years of active participation in agriculture in a variety of capacities, including an active farmer and almost 3 years as a bank commissioner, I assure you that the result of Senate bill 744 will be most undesirable.

It is quite ironic that this bill and similar bills that are touted to "help the farmers market their crops" will predictability result in the farmers being unable or less able to obtain urgently needed financing for crops and livestock.

I strongly admonish you to avoid succumbing to the pressures of the international grain barons and the mammoth processors of poultry and meat products and look to the best interest of all agriculture, particularly the farmers and ranchers. If you do so, I am confident that you will reject Senate bill 744 or that you will drastically amend the bill so as to remove the portions that will significantly reduct the farmers' and ranchers' ability to obtain credit, increase paperwork, create chaos and confusion which will lead to expensive litigation.

Thank you for permitting me to appear before you. I shall be happy to respond to questions.

RESUME OF MARLIN D. JACKSON, BANK COMMISSIONER, AR

April 15, 1983, Governor Bill Clinton appointed Marlin Jackson Bank Commissioner. As such, he has supervisory and regulatory responsibilities and authorities over the 185 State-chartered banks, two trust companies, and three industrial loan institutions.

Mr. Jackson has more than 25 years' experience in banking. He served as chairman and president of Security Bank, Paragould, for the past 14 years. Previous to that, he was employed at Citizens Bank, Jonesboro, Arkansas.

He is on the faculty of various banking schools, including Stonier Graduate School of Banking, Rugters The University; School of Banking of the South, LSU; Mid-South School of Banking, Memphis State; and National Agricultural Bank Management School at Iowa State University, Ames, Iowa.

Agriculture is a fundamental part of Marlin's career and background. As a youth, he was active in the Future Farmers of America. He served as a State officer and received his State and American degrees. He has interests in agricultural-related businesses and ownership interest in farms in Craighead and Greene Counties. He is a former vocational agricultural teacher.

He has been very active in the American Bankers Association. He served as chairman of the agricultural division of the American Bankers Association and has served on the Administrative Committee and the Government Relations Council. He has also been very active in the State Banking Association prior to becoming Bank Commissioner.

He is active in the field of education and recently completed a 10-year term on the State Board of Higher Education and a 2-year term on the Education Commission of States.

In addition to his active participation in education, he has been very active in community, civic, and church endeavors. He served for several years as a certified layspeaker for the United Methodist Church, as a member of the Board of Trustees of the Paragould District United Methodist Church, as a member of the Committee of Finance and Administration, and other church commissions. Additionally, he is the past President of the Paragould Area Chamber of Commerce, the Paragould Industrial Development Commission, and he served for more than 20 years as a Justice of the Peace.

Marlin has been much in demand as a speaker and has spoken at bank meetings and Chamber of Commerce meetings all across the United States.

Marlin is an honor graduate from Dixie High School, an honor graduate of Arkansas State University, and a graduate from Harvard Graduate School of Business, Advanced Management Program (AMP).

He is married to the former Betty Nunn. They have four children and a rabbit named Redford.

The CHAIRMAN. They certainly will be, and I would say, Mr. Jackson, you're my kind of a witness—and that isn't a judgment of whether I agree with you on all of your statements or not—you're certainly clear and understandable. There is no doubt about where you stand on the issues and I would like more witnesses to be that direct.

Ms. Lawrence, I just have one question for you.

What is the total amount of dollars of USDA's farm product loan?

$5 BILLION FOR SHORT-TERM OPERATING LOANS

Ms. LAWRENCE. Our Farmers Home portfolio for short-term operating loans for which we would use as collateral produce or chattel is this year about $5 billion.

The CHAIRMAN. And what do you expect to extend on current product loan?

Ms. LAWRENCE. Next year, $4 billion.

The CHAIRMAN. Are these funded by taxpayers' dollars?

Ms. LAWRENCE. Yes, sir, in part.

The CHAIRMAN. And you're willing to relinquish your current lien position on approximately $9 billion of loans?

Ms. LAWRENCE. No, sir. We don't intend to relinquish our liens. We would, under the law as proposed, use the prenotification system.

The CHAIRMAN. Thank you very much. I'm sorry we don't have additional time, but if you would pick up the questions or have someone pick them up later today we would appreciate it. Thank you very much.

Mr. JACKSON. Thank you. On behalf of the Arkansas bankers, Mr. Chairman, we certainly thank you for holding these hearings and for your legitimate concerns for the rights of the States that are really vital to this whole issue. Thank you very much.

The CHAIRMAN. Thank you.

Ms. LAWRENCE. Thank you, sir.

The CHAIRMAN. Panel No. 3, Mr. Glen E. Lemon, Mr. Bud Gerhart, and Mr. Gene Swackhamer. Mr. Lemon, would you like to begin, please?

STATEMENT OF GLEN E. LEMON, CHAIRMAN OF THE BOARD, FIRST BANK & TRUST CO., BOOKER, TX; VICE CHAIRMAN, GOVERNMENT RELATIONS COUNCIL, AMERICAN BANKERS ASSOCIATION

Mr. LEMON. Mr. Chairman and members of the committee, I am Glen Lemon, chairman of the board of First Bank & Trust Co. in Booker, TX; and vice chairman of the American Bankers Association Government Relations Council. Our bank administers about 40 million dollars' worth of agricultural loans. Booker is a small community in the top of the Texas Panhandle composing about 1,300 people when we're all home.

[The complete prepared statement follows:]

STATEMENT
OF
GLEN E. LEMON
on behalf of
THE AMERICAN BANKERS ASSOCIATION

Mr. Chairman and Members of the Committee:

I am Glen E. Lemon, Chairman of the Board of the First Bank and Trust Company in Booker, Texas and Vice Chairman of the American Bankers Association's Government Relations Council. Our bank has assets of approximately $110 million.

The ABA is an association comprised of over 13,000 full service banks which make up approximately 90% of this nation's banking community. While the ABA represents banks of all sizes, 85% of our members have assets of less than $100 million and many of these banks have large agricultural loan portfolios. In fact, 4,000 commercial banks fall under the Department of Agriculture's restrictive definition of being an agricultural banks, i.e., those holding under $500 million in assets with more than 25% of total loans devoted to agricultural related borrowers.

At the outset, we would like to express our appreciation to the Chairman and the Members of the Committee for today's hearings and for requesting referral of S. 744 to the Banking Committee. Mr. Chairman, as your July 26, 1985 letter to Chairman Helms accurately states: "S. 744 is unique . . . . in that it would affect the relative rights of the purchasers and prior lienholders, who are frequently banks, finance companies, and other commercial lenders." We have long felt that S. 744 is unneccessary legislation as our testimony will explain. Procedurally, there is no justification for including S. 744 as a provision in the 1985 farm bill because that legislation is essentially a four year authorization bill for funding the very important food and fiber programs administered by the Department of Agriculture. S. 744 is legislation that has virtually nothing to do with funding the program responsibilities of the Department of

Agriculture, rather it is substantive legislation bearing on the right of every state to regulate commercial transactions within its borders according to state law.

The ABA shares with the Members of Congress a great concern for the economic plight of American agriculture. Bankers are working with their communities throughout this country to work through these extremely difficult times. ABA, in concert with many of the groups testifying today on both sides of S. 744, has taken action to urge legislative and regulatory action to permit banks to continue to meet the financing needs of our agricultural customers.

No doubt the economic hard times wrought on agriculture are causing some to focus on the farm products rule repealed by S. 744. However, we must state that enactment of S. 744 will not help the marginal farm borrower get additional credit. It will, without a doubt, force the lenders to alter their credit position for secured borrowers and generally result in less credit being available for borrowers who qualified for a loan because of the lenders' ability to guarantee the loan with a fully enforceable security interest.

As this Committee is acutely aware, the economic problems of agriculture are also adversely affecting many commercial banks throughout the United States. In March, 1985 the Department of Agriculture published a report entitled "The Current Financial Condition of Farmers and Farm Lenders" which factually summarizes the severity and dimension of the tough financial conditions faced by many agricultural banks. The concluding paragraph of the report well summarizes the situation we in banking are financing -- an important consideration in analyzing S. 744:

> "Banking failures are currently running at 10 times their average annual rate for the past three decades. Institutional lenders, depending on the proportions of their portfolios in farm loans, may not be able to absorb likely increases in the numbers and amounts of troubled farm loans over the next few years without severe problems, further increases in lender failures, and increases in the costs of credit to agricultural borrowers." ("The Current Financial Condition of Farmers and Farm Lenders", USDA, March 1985, page 28).

Enactment of S. 744 will only exacerbate this already severe situation.

Let me now briefly discuss S. 744, which proposes to federally preempt Sec. 9-307(1) of the Uniform Commercial Code. As the Members of the Committee know, Section 9 of the Uniform Commercial Code grants broad legal protection to certain types of agreements and provides as a general rule that a security interest in collateral continues in effect notwithstanding sale, exchange or other disposition by the debtor unless the secured party authorized such action. Of course, not all security interests are created by Section 9. Real estate mortgages for example -- with which this Committee is most familiar -- are created and enforced by other state laws.

S. 744 is often referred to as the "farm products exception" legislation, but we believe that it would be fairer to all parties to label S. 744 as the "farm products mortgage" bill because under the present operation of Sec. 9-307(1) that is exactly the situation we have. The bank or lender holds a mortgage against the livestock or commodity grown by the farmer or rancher; the mortgagor -- who is the farmer or the rancher -- is free to sell his product to a third-party purchaser at any time he chooses for the best price he can get, but a third-party buyer takes clear title to the product only if the seller has paid off his indebtedness in full to the secured party, who usually is the bank.

The situation is analogous to the sale of your residence. You borrow the money to purchase your house from a lender; the lender takes a security interest against your home called a mortgage; and you in the future make the decision when and for what price you want to sell your home to a buyer. Before the buyer can take clear title to your house, you as the mortgagor are obligated by law and contract to pay off your debt in full, otherwise the lender at their option can enforce their lien rights for repayment of the mortgage against either the seller or the third party buyer. The law places the responsibility on the third-party purchaser to check for liens and establish the clear title for the purchase from the seller.

S. 744 would establish new Federal rules to govern all sales of farm products and livestock sales at the state level. Technically, the bill amends the Agriculture and Food Act of 1981 to provide that other law notwithstanding, a buyer in the ordinary course who buys farm products from a seller engaged in farming operations shall take free of a security interest created by the seller, even if the interest is perfected and even if the buyer knows of its existence.

The bill further provides that the buyer will take subject to the security interest if: 1) he receives written notice of the interest and of his obligations within twelve months prior to the sale and 2) he fails to perform those obligations. The notice given by the lender must include the names and addresses of the secured party and the seller, a reasonable description of the property and any payment obligation imposed on the buyer as a condition for release or waiver of the security interest.

The security agreement between the lender and the farmer may alleviate some of the burden on the lender by requiring the farmer to furnish to the lender a list of possible buyers. If the farmer sells to a party not on the list, he may face a maximum fine of $5,000. However, the farmer will not be liable if he has given written notice to the lender of the identity of the actual buyer within seven days prior to the sale or if he has accounted for the proceeds of the sale within tend days after the sale.

In reality, S. 744 guts Sec. 9-307(1) of the UCC. Under the new federal law, a security interest in a farm products transaction would be enforceable against a third-party purchaser only if the lender or the farmer/seller has given written notice of the lien to the buyer prior to the sales transaction. The bill, however, fails to provide any mechanism by which a lender can realistically be assured that adequate notice is given to all would-be-buyers in order to protect the lender's security interest.

Again, the situation is akin to a lender providing you with funds to buy your house and taking back a security interest in the form of a mortgage, but the law provides that the mortgage rights can only be exercised against the individual whom the lender or the borrower guesses will be a likely purchaser at some time in the future! We think that S. 744 is totally unreasonable in expecting a lender to be able to anticipate when and to whom a farmer may chose to sell his mortgaged product. It's a guessing game, pure and simple.

ABA opposes S. 744 for four principal reasons. First, S. 744 is unnecessary legislation because there has been no clear showing of benefit to all parties of a Sec. 307(1) transaction, and -- absent a showing of clear public benefit — there is no reason for Federal preemption of the current law of at least 38 states. Second, the third-party buyer's alleged risk of having to pay twice is greatly exaggerated. The buyer's problems are essentially mechanical in nature. If S. 744's provisions were followed to a logical conclusion, they would abrogate the concept of secured credit. Third, S. 744 attempts to equate farm product financing with inventory financing, when in fact — it is really much more similar to mortgage financing. If the farm products mortgage is eliminated under the UCC, Congress will effectively be removing crops, livestock and other products as reliable collateral for farm loans.

Finally, at a time when farmers are already having problems securing financing and agricultural banks are under pressure to write off loans because of inadequate security, this is an imprudent time to change existing law and further impair the ability of the agriculture to receive financing. There have been no independent economic studies analyzing the benefits, if any, to be achieved by the proposed legislative change, and there are certainly substantial doubts on the part of bankers, regulations, and the legal community as to any positive benefits accruing to agricultural finance by the legislation. Let me discuss each of these points in detail.

Preemption of State Law

One reason ABA opposes S. 744 is because it preempts state law in the area of secured lending. Article 9, the secured lending section of the UCC, is a model state law enacted by every state except Louisiana. The "farm products exception" is not an exception of law because it currently is the law in the majority of jurisdictions. Thirty-seven states and the District of Columbia currently have either the official text of UCC 9-307(1) or its functional equivalent. Eleven states have altered the the type of notice required in order to invoke the exception, but only two states, California and Tennessee, have eliminated the "farm products exception," and Tennessee's deletion is limited. Thus, the enactment of S. 744 would preempt the law as it currently exists in the vast majority of jurisdictions.

Regulation of commercial transactions has traditionally been the province of the states. States currently regulate most commercial and business transactions through state law, including the UCC, which they are free to tailor to their particular circumstances. The primary purpose in enacting the UCC was to allow the states to retain control of the basic commercial law of the country while at the same time encouraging and fostering uniformity. Enactment of S. 744 would certainly not further this goal.

If total uniformity in commercial law is desired, then Congress should not consider piecemeal preemption of various sections of the UCC. Rather, Congress should enact the UCC as statutory federal law -- a proposal that other Congresses have rejected because of their concern for the integrity of our dual system of law. If, however, Congress now wishes to encroach on historic state prerogatives in the area of agriculture finance, a review of the adverse effects of state variation in the Code should be complete and should begin with the Permanent Editorial Board of the UCC. It is for the Board, as the expert on the Uniform Commercial Code, to study any problems which may be inherent in the system and on the basis of its findings, to make recommendations as to whether particular provisions such as the "farm products exception" are in need of revision. In fact, the Board has reviewed the "farm products exception" several times since the adoption of the Code, and as recently as 1978 decided that its retention was desirable.

We understand that the members of this Committee have recently received a letter from Mr. John M. McCabe, the Legislative Director for the National Conference of Commissioners on Uniform State Laws. As that letter points out, the Permanent Editorial Board of the UCC is currently studying Section 9-307(1) in light of the changes in which have been made at the state level. Because of this attention by the Board, ABA believes that federal legislation in the name of uniformity and fairness is unnecessary and particularly inappropriate at this time.

In any event, contrary to the buyer groups' assertions, S. 744 in no way promotes uniform law. It is clear that the bill provides for a "flexible" method of allowing lenders to give notice to buyers. This proposal is unlikely to be an improvement on notice provisions recently adopted by several states. The only uniformity created by S. 744 is that of absolving farm product purchasers from checking for farm liens and placing on lenders the burden of discovering and notifying potential buyers. We believe, that the testimony you will hear from various witnesses providing you with their state perspective on the issue, will persuade you that the problems are not so compelling as to require a federal law and that states have the capacity to work the problem out in a manner satisfactory to most constituents.

Buyer's Risk

Farm products purchasers say they feel present rule is unfair to them because it shifts the risk of a dishonest debtor from the lender to them. They complain that the rule could require them to pay twice (the so-called "double jeopardy" risk) for products serving as collateral for a loan the farmer subsequently fails to repay. While it is true that the buyer of farm products bears the risk of dishonesty on the part of the farmer, well-established and proven safeguards are built into the system which, when properly followed, virtually eliminate this risk. Under the Code, lenders bear the burden of filing documents to perfect their liens. The UCC simply requires the buyer to check for perfected liens on the goods he purchases. If the buyer fails to check and as a result does not follow the requisite payment obligations, and if the production loan is not satisfied, only then does the buyer face the possibility of liability to the lender.

Some buyers argue that they are faced with an unreasonable burden that places them in an unfair position. While checking for liens may be an inconvenient and potentially difficult task in the limited number of states which have chosen to adopt a local, as opposed to a central, filing system -- repeal of the farm products mortgage is not the best means of correcting a problem that is essentially functional or mechanical in nature. A centralized or state-wide filing system, such as that adopted by Nebraska, which mandates 24 hour access to farm lien information, provides an excellent solution to the buyer's problem. In fact, 18 states currently require some type of centralized filing. Today's technological advances in communications and informations systems make such a solution feasible and desirable because it protects both the lender and the buyer.

S. 744 is not the appropriate remedy for the claimed inconvenience suffered by buyers who for their own reasons do not want to check county filing records for perfected liens. The institution of central filing systems states would solve their problems. Federal preemption of state law is not warranted when all states have the ability to address the buyers' complaints with less cumbersome, less disruptive and infinitely more workable remedies.

Finally, S. 744 assumes that lenders are in a better position to police the sale of farm products than buyers are to check for liens. Such an assumption is totally invalid. S. 744 proposes to shift the entire burden of notification to the lender. However, the proposed mechanism for accomplishing this task is woefully insufficient. It assumes that lenders will be able to predict when and to whom a farmer might decide to sell his products. S. 744 requires lenders to rely on disclosures made by the borrower. It is facetious to suggest that the lender depend on the cooperation of a defaulting party for protection. S. 744 provides for a maximum $5,000 penalty for failure to comply. $5,000 is unlikely to provide deterrence against a sale of farm products which can run into hundreds of thousands of dollars.

Farm Products and Inventory

Many proponents of repeal of the "farm products exception" argue that there is no difference between farm products and retail inventory, and therefore, farm products should not be excluded from the buyer in the ordinary course of business exception of UCC 9-307(1). While this argument may be appealing at first glance, examination of the UCC as a whole and of Sec. 9-307(1) in particular provides a ready explanation for the different types of treatment.

The system of secured lending implemented by the UCC followed the weight of pre-Code legal precedence. Historically, there has been separate legal treatment afforded the two types of collateral. Inherent differences between farm products and inventory explain the development of separate rules of the two types of collateral and provide compelling reasons for continuation of those rules. First, the nature of the two buyers is different. The farm products buyer is generally much more sophisticated than the average purchaser at retail for whose benefit the buyer in the ordinary course exception was developed. Second, the two types of sales are different. Whereas the inventory dealer sells products in small quantities and replenishes his stock as it is depleted, the farmer is likely to sell all or the majority of a crop at one time. This type of sale in "bulk" makes defrauding a creditor easier and more tempting. Finally, agricultural products are both fungible and perishable and cannot be easily traced. This makes keeping track of the collateral an exceptionally difficult task for the lender.

The Code implemented several legal rules which together form an effective and balanced system. Removal of the farm products exception from the UCC might narrow the distinction between farm products and inventory, but changing only one provision would certainly skew the balance in the present system. Farm products lenders would receive less protection from the fraudulent acts of borrowers than would inventory lenders.

Inventory lenders can at least rely on the bulk sales provisions of Article 6 of the Uniform Commercial Code to aid in protecting their interest and used as collateral. Article 6 requires compliance with special notice formalities in connection with "bulk transfers" -- transfers usually by a retail merchant of some substantial part (normally over 50%) of his inventory other than in the ordinary course of business. Failure to comply with Article 6 renders the transfer to the buyer ineffective, even if he makes a purchase in good faith. The creditors may seize the goods by judicial process in satisfaction of their debts as if the transfer had never been made. Only where the bulk buyer transfers the goods to a subsequent good faith purchaser for value does an innocent second buyer receive clear title.

Effects on Agricultural Credit

Perhaps the most compelling reason why S. 744 should not be enacted is that it would have serious detrimental effects on the availability of production credit. Many farmers today are in a highly precarious financial situation and depend on the availability of credit for their economic survival.

S. 744 eliminates the lender's ability to rely on perfected agricultural liens to enforce debt obligations. Repeal of the UCC farm products exception will effectively remove crops, livestock and other farm products as reliable collateral for farm loans. Enactment of S. 744 would have the effect of substantially reducing the willingness of creditors to lend to farmers. In order to attain the same level of protection against default that is provided by the farm products exception, lenders would be forced to seek more collateral for their loans or to lend only to those farmers who qualify for unsecured loans. In either case, the cost of credit would increase while the overall amount of available farm credit would be reduced. Higher-risk farmers will probably be unable to obtain credit from traditional lending sources.

The inability of financially distressed farmers to obtain credit would also result in the further involvement of the federal government in agricultural financing since the Farmer's Home Administration provides loans to farmers when no other credit is available. The FmHA already has approximately $31 billion in direct loans outstanding to farmers. In addition, Commodity Credit Corporation currently has $12 billion in commodity loans outstanding. Repeal of this provision shifts additional credit risk to the federal government. Thus, S. 744 will eventually result in a greater burden on the U.S. taxpayers.

The elimination of the farm products exception must also be viewed from the perspective of the agriculture lender itself. As Congress and this Committee are probably well aware, agricultural banks are facing an increasingly bleak future. A recent report reveals the ever growing number of failing agricultural banks. In 1983, only 16% of bank failures (7 of 44) involved agricultural banks. In 1984, that figure had soared to 41% (32 of

78). Through July 16 of this year the figure had increased to 62.5% (39 of 63). S. 744 will likely result in bank examiners' subjecting agricultural loan portfolios to even greater scrutiny. With the removal of the farm products exception, agricultural loans will be viewed as riskier propositions, triggering examiners' requests for increased loans-loss reserves which could further jeopardize the capital position of banks.

Conclusion

In conclusion, Mr. Chairman, the proponents of S. 744 argue that the legislation is desirable because in the sale of mortgaged commodities it would correct the current "double jeopardy" situation to which third-party buyers may be subject to if they do not check for liens prior to their purchase.

Yet, the unalterable fact remains that in freeing buyers of farm products from an obligation to perform UCC searches, damage may be done to other innocent parties. Banks and other lenders will be damaged by a change in the law because the security interest they take for making the loan will be less reliable for assuring repayment of the loan and this will compel banks to reevaluate the credit worthiness of certain farm customers. Depending on how the bank regulatory agencies view a mortgaged commodity without full enforceability, reclassification of a bank's portfolio may potentially occur and this would impair the flow of credit to agriculture when compared with other types of secured lending available.

The farmer or rancher is damaged by enactment of S. 744 because under present circumstances in most jurisdictions, a lender in making a loan has both cash flow and collateral as criteria for evaluating a lending decision. If the farm product mortgage were removed, crops, livestock, and other farm products would no longer be reliable collateral for mortgage loans. Thus, many farmers who are already marginal credit risks will find that the amount of credit that will be extended to them is decreased because a prudent lender without an adequate security interest will not have an adequate econonomic basis for making additional loans.

Regrettably, until this morning's hearings, the Congress was on the verge of the enactment of this legislation without adequate consideration of the consequences of their action to all parties of interest, including the states, the farmers and ranchers, the third-party buyers, bank regulators and the lenders. To date, the justification for S. 744 is primarily a concern for limiting the financial liability of third-party buyers by "double jeopardy" and providing these buyers with "clear title." We believe that today's hearings show at least three other factors that are material and should be considered by the entire Congress in legislation on this issue:

- S. 744 will have an effect on the underwriting of future agricultural loans, and this will generally be adverse to the interests of a marginal farmer;
- S. 744 will definitely limit credit availability to the farm sector from commercial banks;
- S. 744 will more than likely affect the classification of loans held by regulated state and national banks and would also have an impact on the beleaguered Farm Credit System and Farmers Home Administration if they were held to the same regulatory standards as banks.

Based on what we have said today, we strongly believe that S. 744 is legislation that is undesirable to banking and the farm customers we finance. We are agreeable to working with the Congress, the buyer groups, and others to continue to improve the system for financing agricultural products. Several specific suggestions that we might offer the Committee are these.

- We are certainly mindful of actions taken by states like Nebraska, North Dakota, and others to provide centralized filing, which we feel goes a long way toward meeting the objective of providing ease of search for UCC liens. A major defect in S. 744 is that by opting for complete Federal preemption, it provides no opportunity for state experimentation or perfection.
- This Committee has in the past heard arguments by the banking industry for the need for Federal preemption, we believe that the Committee under both Chairman Garn and Chairman Proxmire has always assured that any Federal preemptive legislation provide an adequate opportunity for state overrides. We see no reason why such a factor should not be incorporated into S. 744 if the Congress ultimately decides that Federal preemption is warranted -- though, as noted, we believe no such preemption is warranted.
- We urge that the Committee on Banking assist the Agriculture Committee in the development of an understanding for the fact that banks are regulated depository institutions and that any Federal law potentially affecting the safety and soundness of the private commercial banking institutions should provide the

Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation with ample regulatory authority and supervision over the qualification of these loans.

- It would also be our recommendation that, before the Congress takes final action on this matter at this extremely sensitive time in the agricultural lending cycle, Congress first mandate an Inter-Agency Study Group composed of the Department of Agriculture, the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Farm Credit System to: (1) meet with all the parties of interest in a farm products transaction presently covered by Sec. 9-307(1); (2) to determine the need for a Federal law in the area, if any, and to recommend the scope of legislation as needed; and (3) report back to the Congress within a period of 18 months.

Mr. Chairman, while we have expressed opposition to S. 744 today, we hope that in providing you with these specific recommendations which have ample precedent with this Committee and prior Congresses, you will accept our bona fide interest in working toward legislative solutions that help our industry continue to best serve the financing needs of the American public. Thank you for listening.

Mr. **Lemon**. In closing, let me refer to you the letter that each member of the Senate Banking and the Senate Agriculture Committees have received from the National Conference of Commissioners on Uniform State Laws. This group which originated the Uniform Commercial Code has some definite ideas and suggestions which we should be considering before we take any final action on this legislation. I refer that to you for your further review and thank you again for providing this opportunity to testify.

The **Chairman**. Thank you, Mr. Lemon.

Mr. Gerhart.

STATEMENT OF BUD GERHART, PRESIDENT, FIRST NATIONAL BANK, NEWMAN GROVE, NE; CHAIRMAN, RURAL AGRICULTURE COMMITTEE, INDEPENDENT BANKERS ASSOCIATION OF AMERICA

Mr. **Gerhart**. Thank you, Mr. Chairman.

Thank you, Mr. Chairman and members of the committee, I am Bud Gerhart, chairman of the agriculture rural committee of the Independent Bankers Association of America. I am also president of the First National Bank in Newman Grove, NE, a town of 900 people, and a grain and livestock producing area in the north central part of the State. About 90 percent of my loans are to grain and livestock producers.

[The complete prepared statement follows:]

TESTIMONY

of

Bud Gerhart

President

The First National Bank

Union Grove, Nebraska

and

Chairman, Agriculture-Rural Committee

INDEPENDENT BANKERS ASSOCIATION OF AMERICA

on

S. 744

Before the

Senate Committee on Banking, Housing and Urban Affairs

Hon. Jake Garn, Chairman

Washington, D.C.

October 9, 1985

538 Dirksen Senate Office Bldg

Mr. Chairman and members of the Committee, I am Bud Gerhart, Chairman of the Agriculture-Rural Committee of the Independent Bankers Association of America. I am also President of the First National Bank in Newman Grove, Nebraska.

The IBAA has a membership of about 7,700 banks, including several thousand banks which are heavily committed to agricultural lending and therefore are directly affected by the issue before you.

I want to succinctly state our position on this question, and then respond to the questions posed in your letter inviting us to testify.

Our position is essentially this: Lenders, farmers, buyers, and marketers all have a vital stake in the established practice of secured farm lending, which includes the tens of billions of dollars of production credit extended to farmers each year. With over $4 billion of farm production debt in delinquent status at this time, and a much larger volume of such debt in questionable status, it is very important to be able to enforce credit liens on farm products. Buyers and marketers have an essential function recognized in the Uniform Commercial Code for helping to enforce those liens, since they are present at the point of sale of the farm products.

Some buyers and marketers have encountered difficulties in securing timely information on the lien status of farm products offered for sale. Buyers and marketers of farm products should not be exposed beyond their control to potential "double payment" for mortgaged farm products. Likewise, the lender cannot afford to be exposed to a situation beyond his control in which collateral and receivables pledged for debt repayment are sold without accountability for the debt. What is needed is a procedure for enforcing liens which works for both lenders and buyers, and for the overwhelming proportion of farmers who would never renege on their debt.

Your letter to IBAA asked about the prior loss experience of lenders related to buyers' responsibility under the UCC. We believe the UCC procedure is very important in preventing losses, since the known involvement of buyers and marketers in enforcing liens at the point of sale has a crucial deterrent value. Sellers are much less likely to attempt the sale of mortgaged products without applying proceeds to debt retirement, because buyers must check for liens. The losses which will occur from a breakdown of this procedure would be reflected partially in higher credit costs to other farmers.

You asked about credit availability: An effective UCC procedure for the enforcement of liens is a key factor in the willingness and confidence with which lenders extend credit to farmers. This is especially true with respect to highly indebted farmers with serious cash flow and debt servicing problems. There, failure to apply proceeds from the sale of cattle, grain, or other collateral could well result in increased loan losses to agricultural banks--already under stress due to the rapidly deteriorating condition of many of their agricultural borrowers.

Any breakdown in the process for enforcing liens will have to be a major factor in the lender's decision on whether he dare extend credit to many of his marginal borrowers to finance their operations in 1986.

You asked about the effects on the classification of loans. The maintenance of reliable procedures for the enforcement of liens on farm products, including receivables from growing crops and livestock, is closely related to the classification of farm loans by bank examiners. The bank examiners will most certainly be even more critical toward marginal agricultural loans if the assets pledged for repayment might be sold without applying the proceeds to retirement of the loan.

The bill S. 744, as reported by the Committee on Agriculture and Forestry, does not provide the effective enforcement procedure which is needed. The bill would replace the long-established lien filing system with a procedure requiring individual advance notice to all prospective buyers of each farm product which is subject to a lien. Such individual notice would be a relatively inefficient and unreliable way to proceed. For example, it would be impossible for me to notify every potential grain or livestock buyer, including neighbors, that my borrowers may sell to.

A major problem with S. 744 is that it would preempt the steps taken during the past 2-3 years by many of the States, which have taken action to make lien information more readily accessible to buyers and marketers while still protecting the lender. For instance, a number of States including Kansas, Montana, Nebraska, North Dakota, Texas, and many others are establishing central filing systems, or a central registry of liens, where all liens which are filed within the State are duplicated and are readily accessible at one location to any party interested in checking for liens. A recent survey of State laws indicates that at least 18 States now have some form of central filing or central notice system.

S. 744 would preempt the laws of those States establishing central filing systems, even though the central filing system promises to be a much more efficient and reliable way to provide timely notice to a buyer of farm products prior to consumating a sale.

One potential improvement in S. 744 would be to exclude those States which have central notice systems, or which would establish such procedures within a prescribed period of time.

For these reasons, we oppose Federal preemption of the farm products provision of the Uniform Commercial Code and of those State laws which have adapted this provision to make it more workable for lenders and buyers.

We want to work with this Committee towards a constructive solution to this question.

This concludes my prepared statement, and I would be pleased to respond to any questions.

The **Chairman**. Thank you.

Mr. Swackhamer.

STATEMENT OF GENE SWACKHAMER, PRESIDENT, FARM CREDIT BANK OF BALITMORE; ON BEHALF OF THE FARM CREDIT COUNCIL

Mr. **Swackhamer**. Thank you, Mr. Chairman. My name is Gene Swackhamer. I'm president of the Farm Credit Banks of Baltimore and I'm also here to offer testimony on behalf of the Farm Credit Council. The Farm Credit Council is a trade association comprised of agricultural lenders that function or operate on a borrower owned basis. That includes the 37 farm credit banks, approximately 739 production credit associations, Federal land bank associations, and other agricultural lenders.

I have prepared a statement and attached to the statement is an alternative bill that we would like to submit to the committee for its consideration and with your permission I would like that the statement and the alternative bill be included as a part of the record.

The **Chairman**. We will include both in the record.

[The complete prepared statement follows:]

THE FARM CREDIT COUNCIL
1800 MASSACHUSETTS AVE, NW · WASHINGTON, DC 20036 · 202/466-4180

Statement of

Gene Swackhamer

Mr. Chairman, I am Gene Swackhammer, President of the Farm Credit Banks of Baltimore and also President of the Baltimore District Farm Credit Council. I I am pleased to appear before this Committee today on behalf of The Farm Credit Council.

As you may know, the Council structure was formed in late 1982 as the federated national association of borrower-owned farm lending institutions across the country. Its federated membership includes all thirty-seven of the nation's Farm Credit banks, some 739 (over 93 percent) of the production credit and federal land bank associations, along with a number of other borrower-owned farm lenders nationwide.

Collectively, these farmer-owned and farmer-directed institutions have presently more than $75 billion in loans outstanding to nearly a million of our nation's farmers and their cooperatives. That constitutes about one-third of the total U.S. farm debt. During the current period of severe stress in the farm economy, never has the role of our institutions been more crucial in assuring the availability of sound and constructive credit to U.S. agriculture.

On several occasions in this and the last Congress, the Farm Credit Council has testified in opposition to legislation, the effect of which was merely to preempt the laws of fifty states by deleting the farm products exception of the Uniform Commercial Code. Mr. Chairman, such opposition was based on a policy resolution of the Farm Credit Council which nevertheless goes on to acknowledge the problems that exist under current law and the need for an alternative that would better serve the entire agricultural industry. We are not here today to argue that all the problems cited by the buyer groups are illusory.

At the same time, the Farm Credit Council has consistently maintained, as we do today, that any lasting solution to the so-called "double jeopardy" problem must result in a sharing among all segments of the industry--buyers, lenders and producers--of the responsibility for ensuring that security interests in farm product collateral are satisfied. We have also maintained that any legislative solution which reduces the degree of protection afforded lenders under current law will inevitably translate into restricted availability of operating credit for many small, beginning, and marginal farmers, and into higher interest rates for all agricultural borrowers commensurate with the increased risk that lenders would incur. I should not have to remind anyone, especially today, of the need to avoid either of these consequences. Our concern is not that legislation as described above will put lenders out of business. Our concern is that it could put farmers out of business.

Previous bills addressing the subject of farm products liens would have removed all protections that lenders enjoy under current law; The Farm Credit Council has been unyielding in its opposition to such an approach. We are pleased that S.744 rejects such an all-or-nothing approach, and to that extent the bill is a step in the right direction. However, as introduced and reported by the Senate Agriculture Committee, S.744 suffers from a number of technical flaws and, more significantly, does not afford lenders an adequate means of protecting their collateral such that the unintended consequences just referred to--namely, restricted availability of farm credit and high interest costs--would be avoided. Finally, by failing to involve the producer in any way, the bill does nothing to deter diversions of collateral proceeds. Accordingly, The Farm Credit Council must oppose S.744 in its present form.

As introduced, S.744 places all of the responsibility for protecting farm collateral on the lender; there is no sharing of responsibility between lender, buyer and producer but instead a complete and total transfer of responsibility to the lender alone. Moreover, the sole means by which S.744 permits lenders to protect their collateral would be largely ineffective for reasons I will discuss shortly.

The problem under current law is not that lenders have too much protection; the problem is that buyers lack an easy and practical means of determining whether a security interest exists in the farm products they purchase. The solution, therefore, lies not in reducing the protections which farm lenders currently enjoy, but rather in devising a means by which buyers can more readily and efficiently determine whether the commodities they purchase are encumbered. Having made that determination, a buyer can then protect himself by the simple expedient of a joint check; that is to say, the buyer's check can be issued jointly to the producer-seller and the secured party, thereby relieving the buyer from any liability by ensuring that the secured party receives the sale proceeds to which it is lawfully entitled.

The most serious deficiency in S.744, as introduced, is that it does not establish a workable mechanism by which prospective buyers can obtain notice of outstanding liens; in fact, as presently drafted the bill would in many instances permit a buyer to take free of an existing security interest "even though the buyer knows of its existence." That hardly sounds like an equitable sharing of responsibility.

Under the bill as introduced, a buyer of farm products would take free of a security interest created by the seller, "even though the buyer [knew] of its existence," unless the secured party or the seller had furnished the buyer written notice of the security interest within twelve months prior to the sale. The problem with this approach is that a lender has no way of determining with any degree of certainty to whom his borrower will sell unless the borrower has contracted in advance to sell his crops or livestock to a particular buyer.

The seemingly simple task of asking a producer at the time he borrows his operating money to list prospective purchasers of the crops or livestock yet to be produced or raised necessarily assumes the producer knows at the time he takes out an operating loan to whom he will ultimately sell. Moreover, it assumes that a producer who is intent upon diverting collateral proceeds and thereby defrauding his lender will feel honor-bound to sell only to the buyer he has previously listed with his lender.

Unfortunately, the procedure for notifying buyers of existing liens envisioned by S.744 can actually facilitate diversions of collateral proceeds by that small percentage of producers whose fraudulent conduct is the underlying cause of the problem this bill seeks to remedy. Having listed prospective purchasers with his lender, a producer intent upon diverting collateral proceeds can avoid a joint-payee check by simply selling his crops or livestock to someone else.

Faced with this prospect, responsible lenders would have no alternative but to inundate their respective trade areas with computer-generated lists of borrowers on whose crops or livestock they hold a lien. Because the information on such lists would quickly become dated, many lenders would not be content with merely updating their lists at twelve-month intervals. We submit that few buyers who give serious thought to the resulting administrative burdens that would fall to them under this approach will conclude that S.744, in its present form, is the solution to their problems.

At the same time, The Farm Credit Council recognizes that the notice procedure envisioned by S.744 may indeed be one part of the ultimate solution. Stated another way, the notice procedure embodied in S.744, coupled with an alternative notice procedure which is buyer-driven and takes place at the point of sale, might well present a workable compromise solution to the problem of "double jeopardy."

In our efforts to find a constructive alternative to both the status quo and S. 744, the Council has worked very closely with the National Council of Farmer Cooperatives (NCFC), with which it is affiliated. From the membership of NCFC, which includes both buyer groups and Farm Credit banks, a task force reflective of those diverse interests and all sides of the issue was assembled. We believe the final product of that joint task force (chaired by a buyer representative) is a true and reasonable compromise--one that recognizes the problem of notice for buyers, but also involves a sharing and not just a shifting of responsibility among all the interested parties to see that the loan obligation is met.

Attached to my written testimony is a copy and short summary of our draft proposal, which envisions just the kind of "hybrid" approach to which I refer. It would combine the actual notice concept in S.744 with a "lien disclosure certificate" concept already adopted in several states. Under such an approach, a buyer of farm products would have to obtain a signed statement from his seller disclosing the existence of any liens unless the buyer had previously received notice of a security interest from a secured party; by so doing, the buyer would be totally relieved of any potential liability to the secured party--even if the producer has falsely stated on the certificate that a lien does not exist.

As introduced, S.744 at least hints at this concept by indicating that a buyer would take subject to any security interest of which the secured party "or the seller" had given written notice. The flaw in this approach is that it places the onus of giving notice at the point of sale entirely on the producer-seller, who under S.744 has no incentive for giving such notice; under our draft alternative bill, the buyer would request such notice from the seller at the point of sale--the one part of the transaction to which the lender is not a party

Mr. Chairman, these are highly stressful times when the unique risks associated with agricultural financing have never been more apparent. What is needed is a lien solution sensitive to the lenders' need for adequate protection of their collateral. Yet it must also provide buyers with a reasonable way of avoiding any liability for double payment in the event the producer wrongfully diverts the proceeds from the sale of a mortgaged commodity. Our proposal achieves both of these objectives.

We urge you to give favorable consideration to the FCC/NCFC alternative. We believe it is the only serious proposal now on the table that draws combined support from buyer, producer **and** lender groups.

The Farm Credit Council appreciates the opportunity to present its views before this Committee. I would be pleased to respond to any questions you might have.

FCC/NCFC Farm Products Lien Alternative Proposal

Below is a short summary of the FCC/NCFC alternative proposal designed to amend the UCC regarding the treatment of security interests on the sale of agricultural commodities:

Actual Notice/Producer's Certificate Options

The buyer will take free of liens, provided--

1. settlement is made by check issued jointly payable to parties of whose interest the buyer has been notified in writing through either a notice from the lender or a certificate from the producer within the 12 months preceding the sale, or

2. in the absence of such notice, the buyer has requested and received from the producer within the 12 months preceding the sale a certificate of ownership indicating the absence of liens for the commodity. By so doing, the buyer is relieved of potential liability even if the producer has falsely stated on the certificate that a lien does not exist. The certificate would include a warning of criminal penalties for false statements and diversion of proceeds.

Criminal Provisions

1. Failure to apply proceeds from the sale of products against a lien would be a criminal offense.

2. Failure to remit within 10 days would be prima facie evidence of fraudulent intent.

3. A false statement on the certification would be a criminal offense; however, remittance within 10 days would be a defense against the charge of fraudulent intent.

4. Criminal charges on transaction values of less than $10,000 would be a misdemeanor. Criminal charges on transaction values of $10,000 or more would be a felony.

Statute of Limitations

This would be shortened to two years from the date of sale.

FCC/NCFC Alternative Bill (Revised 4/30/85)

DRAFT

That this Act may be cited as the "Farm Products Buyers' Equity Act of 1985."

FINDINGS AND PURPOSE

SEC.2.(a) The Congress finds that --

(1) certain State laws permit a secured lender to enforce liens against a purchaser of farm products even if the purchaser does not know that the sale of the products violates the lender's security interest in the products, lacks any practical method for discovering the existence of the security interest, and has no reasonable means to assure that the seller uses the sales proceeds to repay the lender;

(2) such laws subject the purchaser of farm products to double payment for the products (once at the time of purchase, and again when the seller fails to repay the lender);

(3) the exposure of purchasers of farm products to double payment inhibits free competition in the market for farm products; and

(4) this exposure constitutes a burden on and an obstruction to commerce in farm products.

(b) The purpose of this Act is to remove such burden on and obstruction to commerce in farm products.

SEC.3. For purposes of this Act --

(1) the term "buyer in the ordinary course of business" means a person who (A) in the ordinary course of business, buys farm products from a person engaged in farming operations who is in the business of selling farm products, and (B) buys the products in good faith and without knowledge that the sale is in violation of the ownership rights or security interest of a third party in the products;

(2) the term "farm products" means crops or livestock used or produced in farming operations or products of crops or livestock in their unmanufactured states (such as ginned cotton, wool-clip, maple syrup, milk, and eggs) that are in the possession of a person engaged in farming operations; and

(3) the term "security interest" means an interest in farm products that secures payment or performance of an obligation.

PROTECTION OF BUYERS OF FARM PRODUCTS

SEC.4. Notwithstanding any other provision of Federal, State or local law --

(a) (1) A buyer in the ordinary course of business shall take farm products free of a security interest created by the seller of the products, even though the security interest is perfected, provided the buyer

(A)(i) receives written notice from the secured party identifying the person who created the security interest and the farm products subject to the security interest; or (ii) obtains, if the buyer has not otherwise received written notice under subsection (A)(i), prior to payment of the sale proceeds to the seller written notice from the seller disclosing the existence of a security interest in the farm products and the identity of the secured party, or if no security interest in the products exists, stating that fact; and

(B) includes the name of any secured party disclosed by any such notice as joint payee on the check or other instrument issued in payment for the farm products, unless the secured party gives the buyer written notice of waiver of such requirement.

(2) For purposes of this section, a buyer in the ordinary course of business may rely on the information obtained from the seller in a notice under paragraph (1)(A)(ii) for a period of one year after the date of the notice or until such time as the buyer receives actual notice of a change in the information contained in the notice, whichever first occurs.

(3) For purposes of this section, a notice received from the secured party under paragraph (1)(A)(i) is effective for one year, and a buyer in the ordinary course of business may rely on that information for a period of one year after the date of the notice or until such time as the buyer receives actual notice of a change in the information contained in the notice, whichever occurs first.

(4) A buyer in the ordinary course of business who fails to comply with the provisions of paragraph (1) shall take farm products subject to any perfected security interest in the products created by the seller.

(b) (1) A commission merchant or selling agent who sells farm products for another for a fee or commission shall not be liable to the holder of a security interest in such products, even though the security interest is perfected, provided the commission merchant or selling agent

(A)(i) receives written notice from the secured party identifying the person who created the security interest and the farm products subject to the security interest; or (ii) obtains, if the commission merchant or selling agent has not otherwise received written notice from the secured party under subsection (A)(i), prior to payment of the sale proceeds to the seller written notice from the seller disclosing the existence of a security interest in the farm products and the identity of the secured party, or if no security interest in the products exists, stating that fact; and

(B) includes the name of any secured party disclosed by any such notice as joint payee on the check or other instrument issued in payment for the farm products, unless the secured party gives the buyer written notice of waiver of such requirement.

(2) For purposes of this section, a commission merchant or selling agent may rely on the information obtained from the seller in a notice under paragraph (1)(A)(ii) for a period of one year after the date of the notice or until such time as the commission merchant or selling agent receives actual notice of a change in the information contained in the notice, whichever first occurs.

(3) For purposes of this section, a notice received from the secured party under paragraph (1)(A)(i) is effective for one year, and a commission merchant or selling agent may rely on that information for a period of one year after the date of the notice or until such time as the commission merchant or selling agent receives actual notice of a change in the information contained in the notice, whichever first occurs.

(4) A commission merchant or selling agent who fails to comply with the provisions of paragraph (1) shall be liable to the holder of any perfected security interest in such products created by the seller to the extent the secured party does not receive the proceeds from the sale or other disposition of such products.

(c) A buyer in the ordinary course of business who obtains a notice under subsection (a)(1)(A), or a commission merchant or selling agent who obtains a notice under subsection (b)(1)(A), shall not publicly post or disseminate to any person other than its agents and employees any information contained on such notice.

(d) It is unlawful for a seller of farm products engaged in farm operations who is in the business of selling farm products (1) who has no right to sell or otherwise dispose of farm products subject to a security interest created by such seller, or (2) who has the right to sell or otherwise dispose of such farm products only on the condition that the secured party receives the proceeds from such sale, to sell or otherwise dispose of the farm products or any part thereof and willfully and wrongfully to fail to pay to the secured party the proceeds from the sale or other disposition. Failure to pay such proceeds to the secured party within ten days after the sale or other disposition of the collateral is prima facie evidence of a willful and wrongful failure to pay under this subsection.

(e) It is unlawful for any person knowingly to make a false statement in any notice obtained by a buyer in the ordinary course of business under subsection (a)(1)(A)(ii) or by a commission merchant or selling agent under subsection (b)(1)(A)(ii). It is an affirmative defense to a prosecution for the violation of this subsection that the secured party received the proceeds from the sale or other disposition of the collateral within ten days after such sale or other disposition.

(f) A person convicted of a violation of subsection (d) or subsection (e) shall, if the value of the farm products involved is $10,000 or more, be guilty of a felony and shall be fined not more than $10,000 or imprisoned for not more than five years, or both, or shall, if the value of the farm products involved is less than $10,000, be guilty of a misdemeanor and shall be fined not more than $5,000 or imprisoned for not more than one year, or both.

(g) The notice obtained by a buyer in the ordinary course of business under subsection (a)(1)(A)(ii) or by a commission mercant or sellling agent under subsection (b)(1)(A)(ii) shall include a warning that any false statement as to the existence of or identity of any secured party is a criminal offense and shall state the penalties therefor.

(h) An action against a buyer of farm products or against a commission merchant or selling agent who sells farm products for another for a fee or commission for recovery of such farm products or their value must be commenced within two years after the date such farm products are sold.

ADMINISTRATION

SEC.5. The Secretary of Agriculture shall, not later than 180 days after the date of enactment, issue final regulations implementing the provisions of this Act.

EFFECTIVE DATE

SEC.6. The provisions of this Act shall become effective 30 days after the date the Secretary of Agriculture issues final regulations under Section 5, but only with respect to security interests created after such effective date.

The **Chairman**. Thank you.

Mr. Lemon, do you know the experience of lenders in Tennessee and California since those States have repealed the farm product exception?

Mr. **Lemon**. I am familiar with the California situation and, of course, much of the sales in agricultural products in California consists of forward contracting, thereby allowing what are in effect a type of assigned transaction.

In the case of the agricultural loan situation in California, one additional point is worth considering. Figures from the Federal Reserve in 1984 tell us that the losses in California are three times as high as the national average running about 6 percent as opposed to an national average of about 2 percent.

WIDE DIVERSITY OF OPINION

The **Chairman**. Mr. Swackhamer, why is there such a wide diversity of opinion between USDA and the Farm Credit Council on this issue? You're that far apart [indicating].

Mr. **Swackhamer**. Well, the USDA I presume is representing the position of the administration. The Farm Credit Council has been trying to work out an alternative between buyers and lenders and the producers and there's just a different perspective being brought to the issue.

The **Chairman**. Mr. Lemon or Mr. Gerhart, do you have a reaction to the Farm Credit Council's alternative proposal? Have you had an opportunity to study it?

Mr. **Lemon**. I haven't had an opportunity to study it. But I want to emphasize that the American Bankers Association is certainly interested in studying the proposal because we are interested in finding a solution meeting the needs of most parties, rather than simply switching the horses in the middle of the stream as is currently being proposed.

The **Chairman**. Mr. Gerhart.

Mr. **Gerhart**. I just heard the proposal and as I understood it the buyer would not be responsible if the borrower who's the seller is dishonest in stating that he has a lien. So I guess my question would be what happens when we have a borrower who is dishonest. As I pointed out earlier, some of these people under this type of stress are doing dishonest things. They're honest people but they're doing dishonest things in these kind of times and I don't understand whether we would be protected. If my borrower, for example, were to sell something to a marketer or a seller and not disclose that he had a lien to me, if there's no liability there, then I don't think I would be adequately protected.

The **Chairman**. Could you both give us a written response by Friday along with the other questions we will ask you?

Mr. **Lemon**. We'll be glad to do so.

[The following information may be found on p. 174.]

The **Chairman**. Thank you very much, gentlemen.

Next I'd like to invite John Miller, president of E.A. Miller & Sons, Hyrum, UT; Marion Luckey, Jr., pecan processor, Harlem, GA; Jim DeGaetano, president, Pennsylvania Livestock Auction

Association; and Dale Seyler, president of Colorado Commodity Traders, Inc.

Mr. Miller, would you like to begin, please?

STATEMENT OF JOHN R. MILLER, CHIEF EXECUTIVE OFFICER, E.A. MILLER & SONS PACKING CO., HYRUM, UT

Mr. MILLER. Mr. Chairman, it's a pleasure for me to be here today. As you mentioned, I am the chief executive officer of E.A. Miller & Sons Packing Co. in Hyrum, UT, and a new acquisition, Spencer Beef Corp. in Nebraska. And now, according to Marlin Jackson, officially the international cattle baron. I don't know if that's a compliment or not. I don't think it is.

We're a family run business. We slaughter and process live cattle in the States of Nebraska and Utah. Presently, we purchase 26,000 cattle a week in 17 States in the West and the Midwest. We also have two feedlots located in Utah and Idaho and we purchase over 300 tons of feed grains daily that these cattle consume daily in these feedlots.

There's a lot that's been said about the product exemption to the Uniform Commercial Code and in effect we don't feel like we should provide insurance for lending institutions in support of this decision to issue credit, particularly since we've had nothing to do with it in terms of making that decision.

RECENT INSOLVENCY PROBLEM

Recently, a lender notified us of an insolvency problem after we had literally placed a check in the mail for $15,000. Fortunately, in this case, we were able to stop payment on the first check and adjust the method of payment to include the bank as a joint payee on the second check.

I might add here that our efforts to protect ourselves from double payment liability is severely hampered by the prompt payment provisions of the Packard Stockyards Act which has been mentioned. We purchase over 4,000 cattle a day and we have 24 hours to pay for those cattle. That's much, much different than buying a home once every 10 years, having 90 days to complete the contract, and having a closing. There's a vast difference in the two comparisons as mentioned by Mr. Lemon.

Fortunately, we've gotten out of a lot of tight situations however. I was talking to one of our competitors this week, XL Corp., asking them about their problems and they're currently in litigation for over $3 million on clear title issues.

We believe that the law of averages will eventually catch up with us, particularly with our new acquisition in Nebraska. There's no way that in the future we're not going to get caught on this issue if we don't get some action and get this thing straightened out.

Contrary to what the opposition and the opponents claim on S. 744, we see that it will have no effect on credit availability. We buy cattle in California, in many States or a couple of States that have done away with this—Illinois and Indiana are two others—we don't forward contract our cattle in California and we don't see that it's had any impact on the issuance of credit availability.

We can't see that it will have any impact on loan reclassification. As we understand it, regulators currently don't even take into consideration the account liability from third-party buyers. Personally, I don't think that there needs to be prenotice on liens. However, in this particular bill, S. 744, it is in the spirit of compromise and it sanctions the lenders the right to protect themselves by providing notice of a lien to the purchaser who would then be obligated to issue multiple party check, or then the buyer would be responsible. We can go along with that. We think that is definitely a compromise on this issue.

Really, the question is one of simple fairness. If we in the conduct of our business either through poor judgment or bad luck assume a bad risk, we do not assume the right to be reimbursed by some stranger whom we've never met.

Senator Garn, you well understand the principle of stewardship and we ask that you don't continue to make us responsible for something that we have not been a party of.

Thank you. If you have any questions I'll entertain those and I also have a personal statement that I would like submitted.

[The complete prepared statement follows:]

AMERICAN
MEAT
INSTITUTE
Serving The Meat Industry Since 1906

STATEMENT

BY

JOHN R. MILLER

CHIEF EXECUTIVE OFFICER

E.A. MILLER AND SONS PACKING COMPANY

HYRUM, UTAH

Mr. Chairman, and members of the Committee, my name is John R. Miller and I am the Chief Executive Officer of E.A. Miller, Inc. of Hyrum, Utah and Spencer Beef Corporation in Schuyler, Nebraska. I am here today on behalf of the American Meat Institute to testify in support of S. 744 -- so called clear title legislation. I welcome this opportunity to discuss an issue of such vital importance to the entire American Agricultural community.

My company slaughters, processes and ships a complete line of beef products from two facilities located in Hyrum, Utah and Schuyler, Nebraska. In addition, we have feed lots in the states of Utah and Idaho. Maintaining a good source of high quality cattle is obviously essential to our business, and we make regular purchases of livestock in seventeen states throughout the west and midwest. On the average, we buy approximately twenty-six thousand head of cattle per week. In addition, we purchase 300 tons of grain such as barley and corn to be consumed daily by cattle in our feedlots.

In arranging these purchases, we find ourselves continually hampered by the application of an unfair and outdated provision of law - the agricultural products exemption to the Uniform Commercial Code. In all other sectors of the economy, a good faith purchaser of a product in the ordinary course of business - both wholesale and retail - takes a product free of any existing security interest. Through this general rule of law, commerce in most items is facilitated and the risk of any default or insolvency remains where it belongs - with the lending organization which voluntarily assumed it. In agriculture, however, this is not the case. To the contrary, as part of every one of my daily decisions to buy cattle or grain, we are forced to run the risk of paying twice for the same product. In effect, we provide insurance to a lending institution in support of its decision to extend credit, a decision which we had absolutely no part in making.

Our company invests substantial resources in our efforts to protect ourselves from such risks. We pursue a strategy of tying up considerable manpower in attempts to identify problem liens, through relationships with various lenders, negotiations with sellers, and the use of traders and other third party merchants. Our efforts are further complicated in the livestock purchasing area, where we are required by the prompt payment provisions of the Packers and Stockyards Act to extend full payment for livestock within one day of its receipt.

Unlike many of my competitors and others who will testify before the Committee today, we have not suffered the misfortune of double payment loss. We attribute this to the investment of effort and resources I mentioned, along with a bit of plain good luck. To cite one example of a close call, a lender recently notified us of an insolvency problem after we had literally placed a check for over $15,000 in the mail. Fortunately, we were able to stop payment on the first check and adjust the method of payment for the livestock to include the bank as a joint payee on a second check. This illustrates that, regardless of the extent of our efforts to avoid these problems, the law of averages will eventually catch up with us, and unless Congress can take decisive action, we can anticipate future situations where we will arbitrarily be forced into substantial double payment liability. Some of our competitors have not been so fortunate. Excel Corporation is currently in litigation over "clear-title" problems that could result in the loss of millions of dollars.

Fortunately, the Congress seems very close to taking just such action. S. 744, co-sponsored by Senators Cochran and Boren, has already been approved by the Senate Agriculture Committee. Identical provisions have already been included in the House version of the Farm Bill. In addition, the Reagan Administration has strongly endorsed the legislation, fully incorporating the perspective of the Department of Agriculture, which is a major source of agricultural credit. Under this bill, fairness would be restored within the agricultural community and we would be placed on an equal footing with purchasers of other goods. Our good faith purchases of grain, livestock and other agricultural commodities would not be subjected any longer to the type of double jeopardy risk I have outlined. As has been illustrated by the experience of the State of California, this can be accomplished without any negative effect upon either the cost or the availability of farm credit.

We would also like to comment on what the bankers call their "loan classification" concerns. They fear that removal of the farm products exception will result in unfavorable reclassification of their farm products loan portfolios by the bank regulators. As we understand it the regulators currently do not take into account the possibility that banks may recover from third party buyers on farm loans in default. If this is so, a change in the protection for buyers could have no bearing on the risk classification of bank loans. AMI is certainly unaware of any reclassification problems in California where the farm products exception was removed in 1976. If the Committee has any remaining concerns on this point, we urge that you ask the bank regulators themselves whether enactment of S. 744 would have any affect on their loan classification policies. We are confident the answer will be NO.

In its current form, the bill also recognizes the lender's right to protect himself. It specifically sanctions his right to provide notice of the existence of a lien to the purchaser of an agricultural product, who would then be obligated to either issue a multiple party check or reassume the risk of double payment. In addition, the bill includes a deterrent to any dishonest activity by a seller of agricultural goods by establishing a civil penalty to be applied to anyone who violates an agreement to inform the lender about his sales practices. This provision would be an addition to other civil or criminal penalities which might be established under state law.

S. 744 therefore resolves the basic fairness problem in this area while still recognizing the legitimate interests of lending institutions. Other so-called compromise positions do not. Suggestions that certificates be issued as part of every agricultural transaction are totally impractical and could drown our industry in a mountain of paperwork, where such paperwork is even feasible. More basically, such an approach distorts the issue by reimposing the burden of policing loans where it emphatically does not belong, with the purchaser of a product. Other suggestions to allow the states broad latitude to establish different systems of central filing and/or notification are actually transparent efforts to nullify the the positive benefits of the legislation. Just as it is impractical for a smaller packer operating in one state to search out liens on a county by county basis, it is impractical on a national basis, to assume the expense and difficulty of sifting through procedures of varying complexity that might be established by fifty different states. In addition, such an approach contradicts the overall purpose of having a uniform commercial code - to facilitate and simplify commercial transactions on a nation wide basis.

In considering some of the details of this issue, I would urge the Committee not to lose sight of its essence. It is a question of simple fairness. If we, in the conduct of our business either through bad judgment or bad luck, assume a bad risk, we do not assume the right to be reimbursed by some stranger whom we have never met, and who had no ability to influence my original decision. That kind of free ride is, in the end, is what the opponents to S. 744 are looking for. There is simply no good reason for allowing this to happen. I would, therefore, ask that this Committee contribute to the progress of this important legislation, by sending S. 744 to the full Senate with a recommendation that it be enacted into law.

That concludes my presentation. I would be happy to entertain any questions.

The CHAIRMAN. Mr. Luckey.

STATEMENT OF MARION LUCKEY, JR., PECAN PROCESSOR, HARLEM, GA

Mr. LUCKEY. Mr. Chairman, it's a pleasure to be here. I would like to submit my formal statement and then make a few brief remarks.

The CHAIRMAN. All of your statements will be included in the record in full.

Mr. LUCKEY. I am here representing the Tracy-Luckey Co. and the National Pecan Shellers Association.

Tracy-Luckey has plants in Harlem, Albany, and Leesburg, GA; and Andalusia, AL. It also has buying locations in Bristol, OK; Las Cruces, NM; along with field buyers in Louisiana, Texas, and Mississippi.

PECAN MARKETING PRACTICES

We expect to buy between 20 and 30 million dollars' worth of pecans this year. Pecans are grown in 14 States and we try to buy in all 14 States. Crop liens are taken in counties where grown, subject to individual State laws. A grower may lease, rent, sharecrop, or own the pecans he harvests and sells. Pecans cannot be identified as to location, State, or county of origin. They have no birth certificate and they have no title, no serial numbers, as machines and cars do, and unlike land and houses, they are portable.

Sometimes liens are in names other than the person selling in a corporation, a partnership, or his wife's name. Pecans are brought into buying locations in paper sacks, pickup loads, and 100,000-pound lots. During buying seasons, cars, pickups, and farm trucks bring in pecans. We frequently have long lines to sell pecans.

Pecans are a very-high priced item and they move to the highest prices. Because of different characteristics and uses, it is not unusual for loads even as small as a pickup load to move 200 to 300 hundred miles to be sold.

HISTORY OF LIENS IN THE PECAN INDUSTRY

Prior to 1985, no one has questioned purchasers after the fact. A few agencies and private lenders had notified us prior to sale and we made the check jointly to the grower and the lending agency. A drastic and dangerous change has taken place. I have a copy submitted from the Albany PCA that will amount to over $100,000 on one grower alone. Also I have a copy of a letter sent by the Thomson Farmers Home Administration threatening us and indicating they have knowledge that we purchased $47,000 worth of pecans from a grower in McDuffie County. They are demanding immediate repayment and threatening legal action. Upon investigation we found no record of such a transaction and found that more than one other buyer, at least, received a similar letter. This seems to be a fishing expedition and to be abuse of their office.

Every indication is that when the loans were being paid and the Farm Credit System was not in jeopardy payment was accepted from the grower and nothing was said. However, now in an effort to cover for poor and careless management in which no effort has been made to answer for the soundness of the loan or sure repayment of the loan, these lenders are coming forward after the sale and demanding the second payment from commodity buyers without prior notice.

In support of the clear title act, various State laws protect the lender who holds a recorded lien. Few give consideration to commodity buyers. Lenders have no legal obligation to notify potential commodity buyers of liens except recording them in a county courthouse.

Under conditions of the pecan accumulating system it is practically impossible to ascertain clear title.

Our position is as follows: Legitimate farm buyers of farm commodities are entitled to protection under the law. We must have a means of obtaining title to commodities purchased. This problem transcends State lines and passage of the Clear Title Act will give the speediest relief.

What will happen in a market in which commodity buyers must be certain of clear title? As we see it, if we and other large buyers and shellers are forced to take such steps, the sale of pecans by growers everywhere will be totally demoralized. However, if we don't take such steps, we risk our very existence.

The effect on the pecan shelling and processing industry is as follows. It will slow down the sale and the harvest of pecans and demoralize the market. It will limit purchases by shellers to larger lots that could be thoroughly researched. It would destroy our buying organization and the pecan marketing network, and it would cut off an important source of supply to us and to the pecan industry.

THE EFFECT ON THE GROWER

Small lots have been sold at considerable discount. Many growers would resort to disreputable buyers to sell for cash and farmers who made the best price would take less.

One effect we see on the lender, if the grower is able to sell for cash and it's nontraceable, then the lender will be out in the cold with very little chance of collecting his money.

This is not an imagined or theoretical danger. It is here at this very moment. Passage of the Clear Title Act is the best offer of the fairest and speediest relief.

In commenting on your question on availability of credit to farmers, I would like to ask a question. What will it do to the credit of agribusiness if they're not able to ascertain clear title? In our opinion, it would dry up our source of funds to the agricultural community. Thank you.

[The complete prepared statement follows:]

STATEMENT OF M. W. LUCKEY, JR., PRESIDENT
TRACY-LUCKEY COMPANY, INC., HARLEM, GEORGIA
BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
OCTOBER 9, 1985

The following states the position of Tracy-Luckey Company, Inc. Harlem, Georgia, concerning the "clear title" legislation now before the U.S. Congress.

INTERESTS OF TRACY-LUCKEY, CO., INC. AND PECAN PURCHASING PRACTICES

Established in 1937 at Harlem, Ga., the principal enterprise of Tracy-Luckey Co., Inc. was, and is now, buying, shelling, and selling pecans. We are probably the leading buyer and sheller of pecans in the USA with processing plants in Harlem, Albany, and Leesburg, in Georgia, and in Andalusia, Alabama. We actively buy pecans from growers, accumulators, and dealers at all four plant locations.

Tracy-Luckey operates buying warehouses in both New Mexico and Oklahoma and employs field buyers to cover Texas, Louisiana, Mississippi and adjoining states.

Through our buying network, Tracy-Luckey expects to buy over 15% of the estimated 1985-86 pecan harvest across the country, with purchases of the Georgia crop to exceed 15%. Practically all of this buying will take place between October 15, 1985 and February 15, 1986.

While Tracy-Luckey owns pecan groves in Georgia and manages additional groves for others, our buying organization still must purchase pecans to supply 95% of our sales commitments.

Tracy-Luckey's purchases of in-shell pecans during the coming season are expected to total between twenty and thirty million dollars. By policy, company purchases are paid by check on delivery of the pecans and all transactions are recorded. While we do not make cash purchases, we do buy any quantity, from a few pounds in a grocery sack to several eighteen-wheel truckloads. During many days of the buying season our buyers make hundreds of single purchases and enter into thousands of transactions during a season. Often long lines of cars, trucks, and pick-ups wait at our buying stations to sell pecans.

Our buyers are trained professionals, familiar with the territories they work, who take care to identify sellers; however, many sellers are unknown to us. Beyond our buyer's general knowledge and the seller's word, we do not know, nor can we prove, the county or state of origin of the pecans. Our buying practices are honest and reputable as are those of most major buyers in the industry.

The preponderance of the total pecan crop is not purchased directly by shellers such as ourselves, but rather by independent accumulators and dealers. Much of this buying is done on an informal basis and practices vary widely. Some buy entirely for cash and keep no records of individual transactions. Throughout Georgia and other producing states, there are hundreds of such buyers, important links in the transit from farm to sheller to market.

No doubt similar structures exist for the purchase of other farm commodities; however, because there is no established pecan market, prices paid are negotiated between seller and buyer and vary widely according to the variety of pecans and the quality of a lot, with wide variations across the producing states. In contrast to some other commodities, there is not now nor has there been a government support program. Another contrast exists because of different usages and characteristics of various pecan varieties: it is not uncommon for even small lots to be transported significant distances to the buyer who pays optimum price for a particular pecan variety. Yet the marketing of pecans from growers to shellers is a fast-moving process and the product is semi-perishable.

PRIOR LOSS EXPERIENCE

We have never, prior to 1985, had title to any of our pecan purchases questioned. In a few instances, the Tracy-Luckey Company has been notified of a crop lien by a lender or a grower. Before 1985 this had always been prior to purchase by us. In these instances payment has been made by check, payable to the grower and to the lending institution in the proper manner. Prior to 1985, no lender has contacted us after a purchase, demanding payment a second time to satisfy a crop lien which existed at the time of our purchase, nor have we received other claims in pursuit of unpaid crop liens. In fact, we never heard of this happening to any other pecan buyers before this year.

CURRENT CONDITIONS

A drastic and dangerous change seems to be taking place. For us, this began in early 1985 and unless our industry has some immediate protection and relief, the 1985-86 buying season could be disastrous to growers and buyers alike.

We refer to the challenge to title of pecans purchased (and to title of other commodities) by both private and federal farm lending agencies. The cause of this sudden change seems to be the massive farm debt and the fact that literally thousands of farmers in Georgia and other states are actually bankrupt. Many foreclosures have already occurred and, apparently, thousands more will.

The farm situation is desperate. In order to support their families and continue their farm operations, many farmers are willing to suppress information on crop liens, and sell part or all of their pecan crop without satisfying the lien. In many of these cases, acknowledging the lien will bring about immediate foreclosure since the lenders will take the entire proceeds of the sale, not simply the portion which will satisfy the lien on the crop of pecans, and the farmers will have nothing with which to carry on through the winter and toward the next crop.

Apparently crop lien information has been suppressed many times in the past, but no corrective measures were taken (regarding joint payables) nor was this issue brought to commodity buyers' attention. By contrast, however, many private lending institutions have approached us prior to sales to ascertain that their investments were secure and that their crop liens would be satisfied in good order. A case in point was made when a grower from whom we purchased changed from financing through the PCA to financing through a private lender. In the years he financed with the PCA, the grower brought to our attention that the check in payment should be made to himself and the PCA jointly. When he borrowed from a private lending institution, he notified us and then a representative of the bank called us, ascertained all the facts, specified a joint payable on the check and directed us where to send the payment for the crop.

Every indication is that when loans were being paid and the farm credit system was not in jeopardy, payment was accepted from the farmers and nothing was said. However, now, to cover for poor and careless management, in which no effort has been made to assure the soundness of the farm or the sure repayment of a loan, these lenders are coming forward after the sale and demanding a second payment from commodity buyers without prior notice or warning.

Another case in point is the letter,["A" attached], from the Farmers Home Administration, Thomson, Georgia, in which is stated, regarding a specified farm, "The value of the property at the time and place of purchase by you was $47,000...Since the indebtedness to the FmHA exceeds the value of the property purchased by you, demand is hereby made on you for payment of that value..." Tracy-Luckey purchase records show no transactions with the persons named in this letter in December, 1984, or at any other time. When contacted by the President and head buyer of Tracy-Luckey, the farmer stated that he had not told the FmHA to whom he had sold the pecans, but that, indeed, they were not sold to Tracy-Luckey Company, Inc., nor to any representative of Tracy-Luckey. Likewise another pecan sheller has received a similar letter from the Thomson FmHA. Apparently the FmHA in Thomson has written to more than one company, making serious threats, for the purpose of attempting to obtain evidence.

Although various states' laws protect a lender who holds a recorded crop lien, none give any substantial consideration to commodity buyers. Under current laws, lenders have no legal obligation to notify potential commodity buyers of crop liens, other than recording the lien in the county courthouse. Thus, the entire burden of learning of the existence of a lien is on the commodity buyer.

Under the conditions of a commodity accumulating system, such as described in the initial paragraphs of this document, it is impossible to ascertain "clear title" to an agricultural commodity. Since there is no certainty of the county or state of origin of a product, nor means to show that a commodity was attached to or grown on a particular piece of land or by identifiable persons, ascertaining that a particular lot of a commodity is lien-free is not possible.

IN SUPPORT OF PASSAGE OF THE "CLEAR TITLE" SECTION

Our position is that legitimate buyers of farm commodities are entitled to protection under the law and must have a means of obtaining clear title to commodities purchased. At this time there is no practical means of establishing clear title to commodities prior to their purchase.

Under present conditions not all crop liens specify which crop is encumbered, but all the products of a particular parcel of land are covered. The obligation to search out in every county courthouse in 14 states a crop lien which may not be listed in a manner recognizably attachable to a particular party, piece of land, or crop should not fall on the commodity buyer.

A farmer who sells a crop or part of a crop and declares that it is lien-free when, in fact, there is a lien is committing a crime. Normally, this would be a substantial protection to the commodity buyer. In the situation today, however, it is not.

For the most part, these people are not thieves, but are unfortunate citizens who are facing the probable loss of everything they have, including the means for future employment and incomes. It is extremely unlikely that a jury in Georgia or any agricultural community will convict a farmer of fraud in such a case. Lenders hesitate to foreclose on them and prefer first to proceed against buyers such as ourselves, as in the case of the letters attached.

For example, Tracy-Luckey is facing a demand which totals more than $100,000.00 from the Production Credit Association of Albany, Georgia, regarding a single grower. [See "B", attached.] In fact, we have known this man for many years and have purchased yearly a large part of his crop. Always the checks have been made to him, and no liens ever reported. No lender has ever approached or notified us. We purchased his pecans last January. About February 1, we had a call from the PCA, demanding full payment again from us. Not only does the history of this particular sale reveal that the PCA representatives knew the likely time of the sale, but also that the location where the commodity was stored was known. We hope that the grower will have enough production this fall to bail us both out. At the current time, however, the lender is naming us in the threatened lawsuit and not the farmer.

In summation, if the current situation is allowed to continue, it is certain that the commodity market, which in the case of our particular commodity is now opening for the harvest season, will be radically altered and to no one's benefit.

Let us ~~project~~ for a moment what will happen in a market in which a commodity buyer must be practically certain of a clear title and therefore must limit his liablity. To be practically sure of clear title, we would have to limit our buying to very large quantities and take the required time to thoroughly check the legal ownership and liens. This would mean destroying our buying organization, and refusing to buy small lots, or any lot to which clear title cannot be proved.

If we and other large buyers and shellers are forced to take such steps, the sale of pecans by growers everywhere will be totally demoralized. However, if we proceed to buy $25 million in pecans without reasonable assurance of clear title, we will be risking our very existence.

If circumstances restrict buyers to provably safe sources and mandate cutting the number of transactions, then, for us, important sources of supply will be cut off. In order not to disclose their crop liens, many growers will resort to buyers who will buy for cash. The lenders will not recover any of their money. And the farmers who most need the best price will take less in order to sell for cash.

This is not an imagined or theoretical danger. It is here at this very moment as the pecan harvest begins. The passage of the "clear title " section is the avenue of speediest relief.

United States
Department of
Agriculture

Farmers
Home
Administration

LETTER "A"

Thomson County Office
P. O. Box 1255
Thomson, Georgia 30824

SEP 1985
RECEIVED

Tracy-Lucky Company, Inc.
Harlem, Georgia 30814

Dear Sir:

It is our understanding that on or about December, 1984, you purchased the following described property from Tom M. Talbott, III., P. O. Box 55, Thomson, Georgia 30824.

Various quanities and varieties of pecans.

That property is covered by a Financing Statements executed by Tom M. Talbott and Lucretia P. Talbott which secures an indebtedness owed to the Farmers Home Administration (FmHA). The Financing Statement covering the property was filed in the Office of Clerk of Superior Court, of McDuffie County, Georgia on January 3, 1984, as File No. 15940. The Financing Statement covering the property was filed in the Office of Clerk of Superior Court, of Hancock County, Georgia on January 6, 1984, as Filed No. 7739.

The value of the property at the time and place of purchase by you was $47,000.00.

Since the indebtedness to the FmHA exceeds the value of the property purchased by you, demand is hereby made on you for payment of that value.

If you do not comply with this demand within 15 days from the date of this letter, I will recommend referral of this claim to the Attorney for appropriate action.

Sincerely,

FELTON G. POOLE
County Supervisor

FmHA Farmers Home Administration is an Equal Opportunity Lender. Complaints of discrimination should be sent to Secretary of Agriculture, Washington, D.C. 20250

LETTER "B"

DIVINE, WILKIN, DERISO, RAULERSON & FIELDS
ATTORNEYS AT LAW
POST OFFICE BOX 64
ALBANY, GEORGIA 31702

WILLIAM T. DIVINE, JR.
EDGAR B. WILKIN, JR.
WALTER M. DERISO
R. KELLY RAULERSON
RICHARD W. FIELDS
JAMES R. PHELPS
KEITH T. DOROUGH
W. DOUGLAS DIVINE

600 N. JACKSON STREET
TELEPHONE 883-1610
AREA CODE 912

April 24, 1985

CERTIFIED MAIL - RETURN RECEIPT REQUESTED

Tracy Luckey Pecan Company
P. O. Box 780
Albany, Georgia 31702

ATTN: Mr. Jim Dendy

Dear Mr. Dendy:

This letter is to advise you that this law firm represents Albany Production Credit Association. That Association has contacted us regarding a purchase by Tracy Luckey Pecan Company of the 1984 pecan crop from Mr. Larry Morey. We are advised that Tracy Luckey Pecan Company purchased Mr. Morey's 1984 pecan crop and paid the proceeds directly to that individual instead of making joint checks to him and Albany PCA. Further, on Monday, April 8, 1985, Mr. Morey advised Mr. Tommy Jowers, President of Albany PCA, that he took the proceeds from the pecan crop and paid others instead of applying it to the PCA debt. Of course, under the Uniform Commercial Code, anyone, including Tracy Luckey Pecan Company, purchasing farm products from the farmer takes subject to any liens of record. Albany Production Credit Association had valid financing statements and, therefore, perfected liens of record upon the subject crop and, thus, had a superior position to the proceeds from the purchase of such crops. As the Uniform Commercial Code mandates that Tracy Luckey Pecan Company would take subject to this lien, it is the position of Albany Production Credit Association that it should either receive the proceeds paid to Mr. Morey from Mr. Morey or from Tracy Luckey Pecan Company. In lieu of such, it would be PCA's position that they should receive the return of the 1984 pecan crop to it.

This letter is sent to you to provide you with notice of Albany PCA's position in this matter and to request that an amicable solution be made to this problem by the voluntary payment to PCA of the monetary proceeds representing the purchase price of the 1984 pecan crop. PCA will accept this money from either Tracy Luckey Pecan Company or Mr. Morey. Under the law, it is Albany PCA's position that each party to the purchase of this pecan crop is responsible for the same. Your prompt reply is expected. YOU SHOULD BE GOVERNED ACCORDINGLY.

Sincerely yours,

Richard W. Fields

RICHARD W. FIELDS

RWF/eb

cc: Mr. Tommy A. Jowers

The CHAIRMAN. Mr. DeGaetano.

STATEMENT OF JIM DeGAETANO, PRESIDENT, PENNSYLVANIA LIVESTOCK AUCTION ASSOCIATION, INC.

Mr. DEGAETANO. Thank you, Senator. I, too, have a prepared statement which I practiced long and hard to read to you and after listening to all the testimony you can take time to read it on your own. I'd just like to talk to you a couple of minutes and hopefully get down to the nitty-gritty.

REPRESENT 27 LIVESTOCK MARKETS

I represent 27 livestock markets in the State of Pennsylvania. After listening to some of these bankers and so forth talk about the rights of the States, which we all agree upon, how about the rights of the people? That's why I'm here.

We have 27 auction barns. All 27 of us have claims from the bankers and the FHA. All 27 of us are in very dire need of some type of legislative support or we're all going to go out of business. Our livestock market is a medium-sized market and our sales gross between $150,000 and $300,000 on the sales of livestock, all of which we can be sued for at any time. We alone paid $8,000 in the last year to the banks and FHA for cattle that we have sold. What is so unfair about this is our sales are immediate. Our sales start at 7 o'clock at night. There is no opportunity for us to go look up any liens anywhere. The Stockyard Act requires payment for livestock within 24 hours after closing the sale. We don't have any time to look up 400 or 500 liens in 7 or 8 counties or even 2 States for that matter.

The man who lends the money, he could surely send out the information as well as the loan application without any trouble at all.

Also, what's so unfair, on the $8,000 that we paid, our company's commission was $160. We made after our expenses $160, less than 2 percent. That's all livestock markets make to operate on. We must carry a bank line of credit of over $200,000 which we pay interest on.

I might add, by the way, that the farmers who have those loans are paying interest on these loans with the banks and the FHA and they sue for the interest as well as the price of the cattle. The problem that we're having, we have $18,000 against us right now that we haven't settled on. We don't know how many more thousands or hundreds of thousands we're going to get. It could go back 6 years. It's pretty nice if you can make a loan and don't even have to watch where you made it. There is no risk involved at all.

But we're here now because we need some help. We have tried to introduce legislation on the State level. Our State representatives all say that since it involves interstate with the livestock they consider it a Federal matter. They don't want to touch it.

We need help from the Senate in order to correct this problem. I'd like to also—I'm sure you have been to a livestock auction. I might take a minute to explain to you how it operates and why it's so unfair. When we open our place of business we have no idea of who or when farmers are going to bring in the cattle. They bring it on their own. There's absolutely no opportunity for us to look up to see if there's a lien against them. If the banks will send us a list and tell us they have a lien we will make joint checks, if the banks notify us. The banks won't notify us. It leaves us in a very poor situation. There's no way that we can trace the liens and therefore we paid for livestock that we can't even make any money off of except less than 2 percent. And I don't think there are any banks that lend to farmers at 2 percent interest.

I have a couple questions that I hope that you will ask the bankers when they pick up their questions. One of them is, how often do they go out and check their loans? We got one case against us for 5½ years. They didn't even know the farmers sold the cattle.

Another question is, I just don't understand how a bank could make a bad loan under the present situation and why other witnesses should be ruined in the process of that bad loan. It's going to cost us money in order to look up liens and so forth, but at least we'll have the opportunity to protect ourselves and the banks will have an opportunity to protect their money and I don't see how it could be any more fair than that.

[The complete prepared statement follows:]

STATEMENT OF

JIM DeGAETANO, PRESIDENT
PENNSYLVANIA LIVESTOCK AUCTION ASSOCIATION, INC.

Mr. Chairman and members of the Committee:

My name is Jim De Gaetano. I manage a livestock market at Carlisle, Pennsylvania and am now serving as President of the Pennsylvania Livestock Auction Association.

I very much appreciate this opportunity to present a statement to the Committee on a subject of great importance to the livestock marketing industry--that subject being what is commonly referred to as "Clear Title."

The livestock marketing industry supports S. 744, a bill which, on passage, will correct a situation that is unfair and unjust. These conditions exist because of the farm products exception in the Uniform Commercial Code. As a result, in many cases, there has been double payment for livestock by marketing businesses. In recent years, the number (and dollar amounts) of claims have grown to the extent that markets consider the risk involving the sale of mortgaged livestock of primary concern.

It is not practical, and, in fact, is often impossible to determine the existence of liens by search, and, at the same time, comply with payment regulations. Dozens, sometimes, hundreds, of consignors from several counties and, often, from more than one state coupled with not only a business need to pay promptly for the livestock, but a law that mandates markets to make payment before the end of the day following the sale, does not allow markets to obtain the lien information which is needed to protect themselves.

A legislative solution is needed. S. 744 is a fair and correct approach to the problem. It is a compromise of the views, on the one hand, that no change should be made, and, on the other, that markets should have no responsibility. S. 744 says simply that buyers and markets will be responsible to lien-holders when they have been notified of the lien.

When S. 744 becomes law, marketing businesses will need to develop systems that can handle a large volume of information. There will be a lot of paperwork--after all, a high percentage of livestock is mortgaged. But, our industry will accept that task because it is in the best interests of the agriculture community.

Livestock marketmen have been active in successful efforts to amend state U.C.C. laws. Those efforts have been worthwhile. They have focused attention on the issue and made people aware of an inequitable law. Those changes have, also, resulted in improvements of business conditions for buyers and selling agents.

However, a federal solution is necessary. Livestock movement and, therefore, livestock marketing, is most often interstate. There is a need for uniformity in the laws governing those transactions.

Of greater importance is the question that surrounds the issue of Farmers Home Administration loans. It is my understanding that courts have disagreed on the issue of which (state or federal) law applies to security interests of FmHA. S. 744 will answer any such question and include federal lenders under the law.

Mr. Chairman and members of the Committee, S. 744 is a means of correcting a situation for buyers of farm products. At the same time, it recognizes the concerns of the lending institutions and addresses them. S. 744 is a reasonable solution that is fair, equitable, and workable.

Thank you.

The CHAIRMAN. Mr. Seyler.

STATEMENT OF DALE C. SEYLER, PRESIDENT, COLORADO COMMODITY TRADERS, INC., GREELEY, CO

NATIONAL
GRAIN & FEED
ASSOCIATION

Mr. Chairman and Members of the Committee:

The National Grain and Feed Association appreciates this opportunity to wholeheartedly support the enactment of S. 744 to correct the very serious mortgaged commodity problem confronting our agricultural industries. We urge this committee to act favorably on this important, and much needed, legislation.

My name is Dale C. Seyler, I am president of Colorado Commodity Traders Inc., a country elevator and subterminal elevator located in Greeley, Colorado. I am a member of the Board of Directors of the National Grain and Feed Association, on whose behalf I appear today. I also am the immediate past president of the Colorado Grain and Feed Association.

The National Grain and Feed Association is a voluntary association of grain and feed firms ranging in size from the smallest country elevator to the largest grain and feed complex. The operations of our 1,250 member companies include country elevators, terminal elevators, feed manufacturers, processors and exporters. There are 48 state and regional grain and feed associations affiliated with the National Grain and Feed Association that represent upwards of 10,000 grain and feed companies nationwide.

Post Office Box 28328 · Washington, D.C. 20005 · Telephone 202/783-2024

The 1,250 member companies of the National Grain and Feed Association comprise those from across this nation that are involved in the buying, selling, processing, milling and shipping of grain and feed to domestic and export markets. As such, our members know all too well the unfair, one-sided nature of the current situation. Agricultural commodity buyers, unlike *any other category of businessman*, are subjected to the risk of substantial losses to cover defaulted loans. We are serving, in effect, as unwilling policemen (or innocent victims) of loans we do not make. It is the lender, not the buyer, who is being paid in the form of interest charges for assuming the risk for collecting on loans that he alone decides to make.

But perhaps what makes this situation most intolerable is that there is *no* action that agricultural buyers can take now in many states, including Colorado, to *guarantee* that the commodities they purchase are free of liens.

As you know, the mortgaged commodity problem originates with Section 9-307 of the UCC, which states that: "A buyer in the ordinary course of business, *other than a person buying farm products from a person engaged in farming operations*, takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence." (emphasis added.) Thus, this "farm products exemption" of the UCC treats producers, buyers and lenders of agricultural commodities differently than all other businessmen. Unlike any other business transaction, a purchaser of grain or livestock from a producer is liable to the secured lender if the producer subsequently fails to repay the debt.

The Board of Directors of the National Grain and Feed Association addressed this critical problem at its meeting on Sept. 11-12, 1984. At that time, the Board adopted a policy calling for federal preemptive legislation to require the prior notification of the existence of liens. The National Grain and Feed Association's policy states that:

"It is the position of the National Grain and Feed Association that Congress should enact federal preemptive legislation requiring that any farmer who executes a mortgage on grain or livestock notify the mortgage holder of the names and addresses of other persons to whom he will market those products. The mortgage holder, if he wishes to have a joint check drawn, shall be required to notify the potential buyers by certified mail of the existence of the lien. If a buyer receives proper notification, he shall be responsible for including appropriate parties on the check drafted for payment. Failure of the mortgage holder to so notify the buyer shall release the buyer from liability. Criminal penalties shall be assessed against a producer who sells to a buyer other than those specified in advance to the mortgage holder in the event the loan is not repaid."

As this policy indicates, the National Grain and Feed Association believes that the problem of double jeopardy is of such importance that it requires a federal solution through action of Congress. And we believe that the principles of fairness and equity embodied so well in S. 744 represent the best solution to the mortgaged commodity problem.

First, this legislation would correct the indefensible inequity of the current system by removing the so-called farm products exception from the Uniform Commercial Code to grant clear title to buyers of agricultural commodities. This action would, at long last, give agricultural buyers the same status as any other buyer in the commercial marketplace.

Second, this legislation would establish a totally voluntary system under which lenders and creditors would have the option to protect their security interests by notifying potential buyers about the existence of liens prior to the sale. Thus, lenders can take positive action to limit their risks.

Under this prenotification feature, each party to a transaction involving agricultural commodities would shoulder part of the burden. The lender or the seller would be responsible for notifying potential buyers about the existence of a lien filed on an affected crop or livestock. The farmer/producer/seller would be responsible for informing the lender at least 7 days prior to sale about the identity of the actual buyer to which he intends to sell, or to make the proceeds of the sale available to the lender as repayment of the loan within 10 days after the sale. The buyer, if notified of the existence of a lien by either the lender or the seller, would be responsible for following through on the payment instructions specified by the lender, such as issuing a joint check. Failure to do so would subject the buyer to liability in the event of a default. Further, the buyer would bear the principal burden for maintaining records on the status of liens of producers about whom he has been notified. These are responsibilities that other buyers in the normal course of business do not have to confront; but they are duties that agricultural buyers are willing to accept to alleviate the ever-present threat of double jeopardy.

Clearly, S. 744 establishes an equitable system in which no one party is totally "off the hook." And it resolves the most critical problem that lies at the crux of the mortgaged commodity problem -- the lack of precise, accurate information to buyers about commodities on which a lien may exist. .

Mr. Chairman, I believe my business experience provides me with a somewhat all-encompassing perspective from which to evaluate this legislation.

As manager of a country elevator, I can attest to the futility of the current system of checking for liens and the devastating effects of paying for the same grain twice. A year ago, my firm was subjected to a double jeopardy claim of $31,000 from the First National Bank of Fort Collins, Colorado, for a producer who had defaulted on a loan. We had checked the county court house records for liens, but the crop had been sold to us by the producer under a different name. After several months of effort and expense, we did finally avoid payment for the claim under a technicality.

But others in our state of Colorado and elsewhere in this nation have not been so fortunate. I personally shared the anguish of a young grain dealer who recently purchased a small country elevator operation in Dacona, Colorado. His business had been operating for less than -- year when he was hit with a $10,000 double jeopardy claim, an amount that equaled his total net profit and nearly put him out of business. Unquestionably, one more hit like that will close his doors permanently.

When this kind of a situation happens, as it does time and time again under our current inequitable system, it hurts not only the country elevator that goes out of business, but his farmer customers and the financial fabric of the rural community in which it occurs.

In addition to my principal occupation as a country elevator manager, I farm 575 acres of corn and wheat in Weld County, Colorado, and Harlan County, Nebraska. And, as a farmer, I am comfortable with the requirements under S. 744 that I inform my lender of the buyers I intend to sell to, if a lien has been placed on my production, and with the penalties for failing to do so. As a farmer, I would utilize the latitude permitted by this legislation to notify buyers of the existence of any liens *myself*. After all, as a farmer its *my* credit rating that's on the line, and I'm going to protect it.

As president of a small commercial *feed lot*, I am frequently placed in the role of a lender in financing producers' feed and livestock requirements. So I, too, when extending credit, will utilize the voluntary provisions of S. 744 to notify potential buyers about the existence of my security interest in a particular crop or livestock.

Lenders, as a matter of equity and fairness, *should* have the responsibility to notify buyers of the existence of a lien and the steps the buyer must legally take to satisfy the security interest. Yet, by not requiring prenotification, S. 744 gives lenders the latitude to make a business judgement on which borrowers' liens notice should be given. Further, by narrowing the scope of the prenotification requirement, as S. 744 does, the process of notifying potential or actual buyers does not have to be overwhelming. Again, though, S. 744 does not forbid lenders from notifying all buyers if they make a conscious business decision to do so.

It is in the interest of any lender to maintain records to perfect, monitor and otherwise keep tabs on the loans he makes; in other words, to know his customers and monitor their liens. That's just a prudent business practice.

Mr. Chairman, the provisions contained in S. 744 are not experimental or untried. Similar clear title/prior notification approaches have been implemented and been found to work well in a number of major agricultural states, including California, Illinois, Indiana, Louisiana, Minnesota, Kentucky, Ohio, Oregon, Tennessee and Washington. These are states in which a vast number of agricultural commodity transactions occur every day.

The prior notification system, which has a proven track record, avoids the pitfalls of a central notice approach, which has been tried and rejected by such states as Iowa and Nebraska. Under central notice, the agricultural buyer continues to expend the effort and expense of conducting lien searches for every commodity transaction, with no certainty that the central notice listings are accurate or up-to-date. Thus, as I noted earlier, under central notice the agricultural buyer faces the risk of receiving inaccurate or partial information, and continues to be at risk for paying for the same commodity twice. And there often are delays in central notice states in removing farmers' names from the lists once the loan has been repaid. These delays in correcting central notice lists -- which can take several months and even years -- brings commodity transactions involving those producers to a standstill.

Importantly, S. 744 does not affect the process by which lenders can perfect their security interests. Lenders still will be able to perfect their security interest and establish priority against other lien holders by filing a financing statement with the Secretary of State's office (in states that have a central filing system) or at the County Court House (in states that do not).

In closing, the National Grain and Feed Association believes that S. 744 provides a national solution to the problem. It would return a level of uniformity to agricultural business transactions between the states. That's particularly important to country elevator operators like myself. I buy grain from farmers in four states -- Colorado, Kansas, Nebraska and Wyoming. This hodgepodge treatment between states of the double jeopardy problem imposes an inconsistency and inefficiency that delays not only the process of merchandising grain and livestock, but also the payment of farmers for their commodities.

This committee can help correct this inequitable situation by favorably reporting S. 744, in its current form as approved by the Senate Committee on Agriculture, Nutrition and Forestry, and by the House of Representatives.

It's been a pleasure for me to present our National Association's views. Thank you for the opportunity. I will be pleased to respond to any questions you may have.

The CHAIRMAN. Thank you. Senator D'Amato.

Senator D'AMATO. Thank you, Mr. Chairman. I would like to thank you for holding these hearings today on S. 744, the Farm Products Purchase Protection Act. Mr. Chairman, in the interest of time, I'd like to submit my statement as if read in its entirety.

The CHAIRMAN. Certainly.

STATEMENT BY SENATOR ALFONSE D'AMATO

Senator D'AMATO. Mr. Chairman, I commend you for holding this hearing today on S. 744, the Farm Products Purchase Protection Act. This legislation is intended to remove an onerous burden placed upon good faith buyers of farm products.

Section 9-307 of the Uniform Commercial Code [UCC] provides:

> A buyer in the ordinary course of business, other than a person buying farm products from a person engaged in farming operations, takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence.

This farm products exception places a potential hardship on the purchaser. It puts him in the position of possible paying twice for his goods—once to the seller and again to the lienholder, usually a bank, if the proceeds of the sale are not used to pay off a secured loan. As a result, the good faith buyer is placed in a position of ensuring the bank that it will not lose on its original loan.

Mr. Chairman, our agricultural community is presently facing extremely difficult times, and this includes agricultural banks. The U.S. Department of Agriculture has reported that bank failures are currently 10 times their annual rate over the past 30 years. The need for a bank to protect its investment is perhaps greater now than ever before. Section 9-307 affords the banks a certain amount of protection.

Several States have already amended section 9-307 of the UCC to require notice of the existence of a security interest in farm products. Some States require actual written notice to potential buyers; other States have established a central filing system for security interests. This legislation will create uniformity among the States by requiring actual notice to prospective buyers of the existence of a security interest.

Mr. Chairman, this legislation must be given careful consideration by this committee. Although it is not our intention to give banks a riskless loan, we certainly do not want to place an unfair and burdensome responsibility upon a good faith purchaser.

Thank you, Mr. Chairman.

The **Chairman**. Gentlemen, let me make an observation as I have read your testimony and listened to the testimony so far today. Getting away from the particular issue, this discussion is setting the pattern once again for issues that I have listened to before in several ways, specifically that people from their business backgrounds, the areas they come from normally would take a position of they don't want Federal Government interference until it is something that affects or benefits them and then suddenly there is a justification why that overall principle no longer fits.

It reminds me this morning on the news I heard some woman saying that she thought that in all these hostage crises that we should not negotiate, we should be tough, we should risk people's lives, but now her mother was on this ship and she had suddenly changed her mind. That's understandable.

BANKING AS WELL AS AN AGRICULTURE ISSUE

But I've seen this happen many, many times. Also, I have seen issues polarized and this seems to be one of those. The reason we asked for jurisdiction over this is because we don't happen to think the Agriculture Committee knows very much about banking. They're not intended to. They don't have staff. They don't have the background for looking into financial matters. And that's why we wanted to take a look at it because it certainly is a banking issue as well as an agricultural issue.

But it also reminds me very much of getting back to an issue several years ago of due on sale which has nothing to do with what you're talking about, but the situation is similar. We had a massive number of failures of S&L's in this country stuck with 25- or 30-year fixed-rate mortgages and their position was that they didn't want anybody to be able to assume mortgages. They didn't want anybody to be able to keep a 7-percent mortgage. On the other hand, the realtors and the homebuilders wanted all the assumptions they could get and neither one seemed to understand that they needed the other.

I sat here after weeks of testimony and told them to get out of here and go out and find a compromise because realtors and homebuilders needed savings and loans to make future mortgage loans and if they were only looking at the immediate situation they were going to dry up. If they insisted on having total assumptions and if the S&L's insisted on the other side of the coin, there wouldn't be any sales for the realtors and the homebuilders.

So finally 11 different organizations came back with a compromise and I made them put it in writing and sign the letter that they had agreed to so that later they couldn't recount.

We are in a similar situation on a totally different issue. In 1977 the delinquencies in the farm loan portfolio held by FmHA were $213 million. Now, 8 years later, it's $6.388 billion. Now, gentlemen, there is a crisis out there. We can sit here and play this game all we want, that banks are bad and banks are trying to maximize their profit and they ought to charge 2 percent interest or whatever. Those are facts—from $213 million to $6.388 billion. We have a crisis in the Farm Credit System of this country and there are rumblings all the time that we're going to be asked to consider—Congress is—a multibillion dollar bailout for that System.

NO REASON FOR DOUBLE JEOPARDY

So I fully understand what you're saying. I said at the outset I don't understand why we should have double jeopardy. I don't understand why you should have to pay twice. You shouldn't. But on the other hand, there's got to be some security or I think S. 744 can drive another nail—it's certainly not the cause, don't misunderstand me—in that coffin and then we're going to be faced with a $200 billion deficit looking at a multibillion bailout of the Farm Credit System.

You've got an interest in banks being healthy as well, so you can borrow money to keep your businesses going. I'm sorry to get off on a lecture, but it's interesting after 11 years here on this committee how many times on a totally different issue the underlying problems are the same, of two sides being polarized, only presenting their position to this committee. I would just suggest for whatever it's worth and probably not very much that the time is long past due and I'm sorry we didn't have this before—I would have made the same suggestion—it's time bankers and producers and everybody get together and see what can be worked out. This should be something that will benefit both sides because if either one of you win you put the other one in trouble and ultimately yourself because you need each other. Just like realtors and S&L's needed each other for the selling and financing of homes in this country and you need that Farm Credit System and those small agricultural banks not to go bankrupt.

We're going to have a record number of bank failures again this year in this country and that's a fact. It's not an opinion. That is a fact. It's going to get worse before it gets better. So we will have written questions for you but I would hope—Mr. Miller.

Mr. **Miller**. I think you're right in what you're saying and the thing that interests me about the whole situation, Senator Garn, is the fact that I agree that we do need the banks and the fact that if the banks would tell us their liens then we would take that responsibility and make sure there's a joint payment. If they can't tell us or don't tell us, it's almost impossible to pay for it that way. So if we could just get notice, then we would take the responsibility and if we don't issue a joint payment then we would be liable to a third party and I think that's a compromise.

The CHAIRMAN. What I'm suggesting is rather than asking Congress to come in here and override all State laws because we have decided that is the thing to do—it's like due on sale. I still get blasted by one side or the other for that particular compromise. I had nothing to do with it. I even refused to attend the meetings. I didn't want anything to do with it. I said you guys go out and lock yourselves in a room and beat each other to death but when you're finished come out with something and we will enact it. And that's what we did.

NEED FOR A COMPROMISE

And with the limited time, I'm suggesting that rather than us rushing through with S. 744 trying to impose it or alter it in some way, I think the different groups ought to get together and see what you can work out. I'm sorry we weren't involved sooner to make that suggestion so we're not on such a deadline for 1 week from now.

Mr. DeGaetano.

Mr. DEGAETANO. Senator, we think S. 744 is the compromise by both parties and what you're saying about the States changing laws is exactly right except if we didn't have the Uniform Commercial Code then it would be all fair on both sides all the way around.

The CHAIRMAN. Well, you're missing my point. It obviously is not a compromise or you wouldn't have such differences of opinion in testimony.

Mr. DEGAETANO. Well, could I ask you something, sir? If you were a banker and you ran the bank, wouldn't you like the law the way it is?

The CHAIRMAN. Certainly, and you would like it changed. That's why I'm saying that you ought to work out a compromise.

Mr. DEGAETANO. We think that S. 744 is the compromising issue.

The CHAIRMAN. Well, that is your opinion and that is why you're here to present that position, but it isn't a compromise if the other side is so—you heard the testimony. You were sitting here.

Mr. DEGAETANO. I'd feel the same way if I were lending money out as they were. That's all I'm asking you to look at.

The CHAIRMAN. And all I'm asking you to look at is the fact that it isn't a compromise and to have some recognition that you need financial institutions to loan you money and if you can ignore an increase from $213 million in the Farm Credit System in delinquencies to $6 billion and the problems of farmers and agricultural banks for your own self-interest, be my guest.

Mr. DEGAETANO. I'm not doing that, Senator.

The CHAIRMAN. That's what you're saying. You're telling me that S. 744 is the answer, but you've sat here and listened to all kinds of other witnesses who don't agree. It isn't a compromise until both sides come in and say we don't like this compromise, we wish we had had our own way, but we recognize it is in the interest of both parties to make some changes so that we can agree on something that helps both of us. That's why I gave you the illustration of due on sale, because you had 11 different positions.

Mr. DeGaetano. Exactly. The point that we're trying to make here, Senator, is that we agree with you wholeheartedly that there needs to be a compromise. But if the banking community will not compromise, what can we do? That's why we came here.

The Chairman. Who's to say they will not just because they happen to be opposed to S. 744 does not mean they are not willing. There were suggestions earlier that there are areas that can be worked out.

Senator Dixon.

Senator Dixon. Mr. Chairman, first of all, I have a statement that I would like to place in the record at the appropriate time and I noticed that a distinguished witness from my State is in the audience, the president of the Illinois Farm Bureau, John White. I might just suggest, Mr. Chairman, that in addition to this question, there is a provision in law in our State that I think is helpful from the standpoint of the perspective of the lender that we as members of the committee might want to look at. And my friend from Illinois is indicating he may be mentioning that.

The fact is that in Illinois we do provide that the seller has to give to his lender a list of his potential buyers and in Illinois, by statute, if the seller—and I'm sure that my friend who will shortly be a witness will elaborate upon this—if the seller than sells to someone other than an individual on the list of buyers, that under Illinois law is a presumption of a fraud which would be ultimately a situation that would involve the seller in a criminal penalty.

So that we do in Illinois do something to address the problem of the irresponsible or even criminally motivated seller who wants to get rid of the product and take the money and run. And I think it's appropriate that we might—and I'm interested to see that that will be a matter we'll discuss further shortly.

I just suggest that as another thing to look at in connection with this whole question.

STATEMENT OF SENATOR ALAN DIXON

Mr. Chairman, I am pleased to be here today as the committee reviews issues raised by S. 744, a bill designed to end the agricultural products exception contained in chapter 9-307 of the Uniform Commercial Code. We have 19 distinguished witnesses before us this morning, and I look forward to receiving their testimony.

Because I am also a member of the Senate Agriculture Committee, which has already reported this legislation, I have some familiarity with the issues it presents. However, because the bill raises important issues affecting the positions of agricultural lenders, I believe it is necessary and appropriate that the Banking Committee consider this legislation.

I understand and appreciate the concerns of buyers of agricultural products. I also understand the concerns of agricultural lenders. I look forward to having the benefit of their expertise and analysis on issues raised by this bill.

Today's witnesses will, I am sure, address questions relating to federalism, to the relationship of this bill to other UCC provisions, such as the Bulk Sales Act, to coverage of sellers' agents as well as buyers, and other issues raised by this legislation.

Their testimony will be invaluable to the Banking Committee as we attempt to quickly discharge our responsibilies before the committee loses its jurisdiction over S. 744 on October 18.

The CHAIRMAN. Thank you, Senator.

Gentlemen, we appreciate your willingness to testify very much. It's been helpful. Thank you.

Next I invite Joann Smith, a rancher from Florida, president of the National Cattlemen's Association; John White, president of the Illinois Farm Bureau; Glenn Rogers, farmer from North Dakota; John Rabbe, farmer from Minnesota; and Seymour Johnson, farmer from Mississippi.

Mrs. Smith, would you like to begin, please?

STATEMENT OF JOANN SMITH, PRESIDENT, NATIONAL CATTLEMEN'S ASSOCIATION

[The complete prepared statement follows:]

NATIONAL CATTLEMEN'S ASSOCIATION

1301 Pennsylvania Avenue, N.W.
Suite 300
Washington, DC 20004
(202) 347-0228

Good Morning:

Mr. Chairman and members of the Committee, my name is JoAnn Smith. I am President of The National Cattlemen's Association. I am a cattleman from Micapony, Florida, just south of Gainsville.

First, Mr. Chairman, I want to thank you and the members of this committee for the opportunity to testify on behalf of the members of the NCA. We endorse S.744 as it is currently written and commend Senator Cochran and others for their leadership. We commend you for recognizing the importance of clear title to agriculture. The National Cattlemen's Association's board of directors and members reaffirmed in July that passage of clear title legislation is a top priority for cattlemen during the 99th Congress.

On Monday the House of Representatives passed a farm bill that contained clear title legislation in the same form as S.744. I trust you will recognize the importance of this bill and proceed expediently to allow S.744 to be added as an amendment to the Senate farm bill when it reaches the Senate floor.

To understand why clear title is important to cattlemen, let me explain my cattle operation. My husband and I operate a cow/calf ranch in northern Florida. We sell 400 to 500 weight calves each year and routinely purchase yearling heifers to replace cows we sell during the culling season. In

---

The National Cattlemen's Association is the national spokesmman for all segments of the nation's beef cattle industry--including cattle breeders, producers, and feeders. The NCA represents approximately 230,000 professional cattlemen throughout the country6. Membership includes individual members as well as 51 affiliated state cattle associations and 18 affiliated national breed organizations.

addition, we buy hay, forage and feedgrains. Consequently, we are always buying and selling farm products. As with most farmers and ranchers, the very nature of our business requires us to be highly leveraged. If we are required to pay twice for cattle, hay or grain it would work a severe hardship on our family farm.

Gentlemen, we are discussing a fairness issue. A fundamental inequity exists in the way purchases of agricultural products are treated under the uniform commercial code. Unlike buyers of any good, commodity or service, buyers of agricultural products do not receive clear title when purchasing these products.

For example, I can take my truck to Williston, about 20 miles from Micapony to get a load of gravel, pay for it and go home with clear title. However, I can take that same truck to town, buy a load of corn, pay for it but not go home with clear title.

As I mentioned, if I was required to pay twice for the cattle or feed I purchase, it would have a disastrous effect on my operation. In many cases, cattlemen such as myself could be forced into bankruptcy if forced to pay twice for a large purchase.

The threat of paying twice "double jeopardy" for farm products places an undue burden on purchasers of agricultural products. As the law currently stands, I must do lien searches to try and protect myself from the risk of double payment, The time spent checking county courthouses and secretaries of state offices is a substantial cost to me and in most cases, just is not practical or economically feasible. If I miss a lien while checking, I am subject to potentially paying twice.

Mr. Chairman, several members of the National Cattlemen's Association have faced the unfortunate situation of double payment. I would like to submitted them for the record.

The farm products exception in U.C.C. 9-307(1) should be removed for the following reasons:

First, it places an undue financial burden on markets to which producers sell their production. We are especially concerned over situations which reduce the economic viability of our domestic agricultural markets.

Second, individual farmers, as well as their markets are being exposed to risk, which can force an operator into bankruptcy. Farmers buy products from other farmers, such as feeder cattle and pigs, breeding stock, grain and hay, and are in some cases being forced to pay twice for these products as their suppliers default on secured debts.

Third, this risk exposure and actual losses from double payment are reflected in the prices paid to farmers and are passed on to other producers in terms of higher marketing fees and processing costs, and eventually are reflected in higher consumer prices for meat, milk, and eggs.

Fourth, current law forces innocent buyers of farm products to become unwilling loan guarantors, in essence assuming the credit supervision responsibilities that rightly belong with the lender who is making the profit off the loan to begin with. At the same time, farm products buyers have no control over the lender's practices, and receive no compensation in the form of interest to cover the risk exposure and jeopardy unknowingly and unwillingly assumed.

A majority of the states have realized the problem exists and addressed it in one form or another. However, as a result, the clear title laws vary widely from state to state. Consequently, the U.C.C. is non-uniform and federal pre-emption is needed to correct the problem. Most cattle and a large amount of feed is sold in interstate commerce. A federal solution is needed by the mere fact that farm products are interstate goods by definition.

The bill we support today S.744, is a workable solution to the clear title problem. It removes the farm products exception; lenders can still protect themselves by notifying buyers of existing liens. This change would shift some of the burden back to the lender and borrower who have the contractual relationship. Lenders only lose the ability to go after an innocent third party buyer upon seller default, but bank still retain the ability to go after the seller, who illegally converts sale proceeds.

In addition, the 7 day/10 day provision in the bill requires sellers to notify the lender if they are going to sell to someone other than a buyer they have told the lender about. If the seller fails to notify the buyer about an existing lien or to inform the lender, the seller is subject to a penalty. Also, state laws exist for conversion, fraud and impairment of a security interest.

Parties that oppose S.744 argue that this legislation could make it more difficult for young, marginal farmers to obtain credit. This concern grabs quick attention because of credit problems currently facing agriculture. However, this argument is not well founded in our opinion.

Clear title legislation does not change the criteria of whether the loan will generate enough income to pay it off. If clear title enters into the discussion of a loan agreement, it must be on the basis of trust or honesty between the lender and borrower concerning repayment. Another argument often made is that S.744 will leave lenders with unsecured loans and therefore lenders will require more collateral. Clear title legislation does not change the secured status of a loan. Lenders will continue to file financing statements to establish priority to other lienholders and buyers not in the ordinary course of business.

The only thing lenders relinquish in S.744 is the ability to go after innocent third party buyers in the ordinary course of business. The prenotice provision allows lenders to notify potential buyers and then buyers are obligated to issue two-party checks if the lender so instructs.

The National Cattlemen's Association joins twenty-seven other national agricultural groups in supporting S.744 as currently written.

Mr. Chairman and members of the Committee, we appreciate your attention to this important piece of legislation. We look forward to working with you and other members of the Senate to insure that S.744 becomes part of the 1985 farm bill.

The CHAIRMAN. Mr. White.

STATEMENT OF JOHN WHITE, JR., PRESIDENT, ILLINOIS FARM BUREAU; ON BEHALF OF THE AMERICAN FARM BUREAU FEDERATION

Mr. WHITE. Thank you, Mr. Chairman. It's a pleasure for me to present the testimony here today on this issue. I am John White, president of the Illinois Farm Bureau and also a director of the American Farm Bureau Federation board of directors. I will just use some highlights from my testimony in the essence of time.

SCOPE OF THE PROBLEM IS ON A SMALL PERCENTAGE OF PRODUCERS

If I could just summarize, the scope of the problem is one of a relatively small percentage of producers. The actual or prenotification procedures work very well and are simplistic in nature. The central filing systems in place in some States are bureaucratic nightmares and certainly are unnecessary. The banking and lending community and borrowers need to work more closely together in managing and monitoring these liens. The prenotification is part of this bill. The penalty, as mentioned by Senator Dixon, are included in S. 744.

In response to your questions and concern about why a Federal statute versus the existing statutes in the respective States, the simple answer I think to that is that too many of our commodities move across State lines so we need some type of Federal statute to work under.

With that, Mr. Chairman, I appreciate the opportunity to express our views of the American Farm Bureau Federation and thank you for the opportunity today.

The CHAIRMAN. Thank you, Mr. White. Let me say that your last remark about needing more close cooperation and work between the banking community and agricultural community was stated much more concisely and briefer than my much longer statement. I really think that is the key to solving this problem rather than either being absolutely for or absolutely against S. 744.

[The complete prepared statement follows:]

THE VOICE OF AGRICULTURE
AMERICAN FARM BUREAU FEDERATION

★ FARM BUREAU ★
★★ the nation's largest general farm organization ★★

STATEMENT OF THE AMERICAN FARM BUREAU FEDERATION
BEFORE THE SENATE BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE
WITH REGARD TO CLEAR TITLE LEGISLATION, S. 744

Presented by John White, Jr., President ILFB
and Member, AFBF Board of Directors

October 9, 1985

The American Farm Bureau Federation is the nation's largest general farm organization with a membership exceeding 3 million member families in 48 states and Puerto Rico. I serve as president of the Illinois Farm Bureau and as a member of the Board of Directors of the American Farm Bureau Federation. I appreciate the opportunity to appear before the Senate Banking, Housing and Urban Affairs Committee regarding Farm Bureau's position on clear title legislation as contained in S. 744.

Farm Bureau policy is debated, amended and revised by voting delegates from each of our member states. At our 66th annual meeting in January, our delegates adopted policies regarding the sale of mortgaged agricultural commodities. Our policy on this issue states: "We support action to eliminate marketing agency liability for the sale of mortgaged livestock and other agricultural products when the farmer-seller or a third party diverts the proceeds from the lienholder."

Farm Bureau has actively sought elimination of the agricultural exception to the Uniform Commercial Code for several years. The double payment liability that currently exists as a result of the farm products exception threatens the economic viability of farmers and of the marketing structure upon which they depend. Farm Bureau supports deletion of the farm products exception primarily as a matter of equity. There does not appear to be a valid reason for differentiating between buyers of farm products and buyers of other commercial goods. Treating farm products differently has only caused serious problems for buyers, sellers and the courts.

We have been asked why a farmers' organization would actively work for an issue such as clear title in which the apparent beneficiaries are the marketing agents or buyers of farm products. We support S. 744 for a number of reasons:

1. Farmers are buyers of agricultural commodities. Farmers buy products such as feeder cattle and pigs, breeding stock, grain, seed and hay from other producers. In the instances where a seller diverts the proceeds from the lienholder, farmers are subject to make double payments. Diversion of funds is not a frequent occurrence. However, a single instance of paying twice for a commodity may have the effect of seriously and adversely affecting a farmer's financial condition including, in some instances, the cause for declaration of bankruptcy.

2. The double payment possibility under the farm products exception poses an undue financial hardship on the markets to which producers sell their commodities. Increasing financial pressure on these markets reduces the economic viability of agricultural markets which threatens to limit potential buyers for agricultural commodities.

3. Losses sustained by marketing agents in the form of double payments are passed on to other producers in terms of higher marketing fees and processing costs.

4. The current law requires buyers of agricultural products to become credit supervisors for loans about which they have little or no knowledge.

The Illinois Farm Bureau was active in support of legislated changes to the Uniform Commercial Code which eliminated the farm products exception and implemented a prenotification system in the state of Illinois. This change occurred prior to the current distressed financial condition in agriculture, and we believe the current system operates both effectively and efficiently despite today's financial stress. The arguments presented in opposition to the changes that were made in the Illinois law have not materialized. Interest rates did not go up in response to the change in the law. Sources of agricultural credit did not dry up, and farmers have not been prevented from using commodities as collateral for agricultural loans. We believe that under the current Illinois law, farmers are protected both in their role as buyer and as seller, and markets to which farmers sell have remained viable.

Farm Bureau supports the federal solution to the problem of different state laws in regard to commercial sales of agricultural products. While a number of other states have modified or are in the process of modifying their commercial codes to address the problem, the solutions which have been adopted are diverse, creating an impediment to commercial sales across state lines. Agricultural commodities, such as livestock and grain, are frequently marketed across state borders which necessitates uniform federal statute in order to clarify the requirements for lien notification. After evaluating the various alternatives, Farm Bureau supports use of an optional prenotification system under which the lender may protect his security interest through notice to potential buyers that a lien exists. Such a system would operate in a similar manner to that which is currently in effect in Illinois.

Prenotification will allow flexibility so that the lender may elect to protect his interest in those cases that warrant such protection. The law provides maximum flexibility so that a borrower is not constrained from making a sale to a person not originally listed as a potential buyer on the lender's loan application. The paperwork burden of the prenotification system is minimized and controlled by the degree to which the lender chooses to exercise his option of prenotification. Under this program, the lender assumes responsibility for monitoring the loans which he has elected to make. It eliminates the unreasonable requirement that has been placed upon agricultural markets which have become credit supervisors for the lending institutions. It is the lender who receives compensation in the form of interest to cover risk exposure and jeopardy that has been voluntarily and knowingly assumed and with whom responsibility for repayment assurance must lie. Farm Bureau believes that clear title legislation is necessary and important to farmers and agricultural markets.

The American Farm Bureau strongly supports S. 744 which rectifies a basic inequity that has been in place for far too long. We urge members of the Senate to support Senator Cochran in his effort to share responsibility for credit supervision among buyer, seller and lender. Thank you for the opportunity to present our views.

The CHAIRMAN. Mr. Rabbe.

STATEMENT OF JOHN RABBE, FARMER, TRIMONT, MN

Mr. RABBE. Mr. Chairman, committee and staff, I am John Rabbe. I'm a corn and soybean farmer in Trimont, MN. I operate a 1,200-acre farm and a soybean seed business selling certified seed, in partnership with two sons. I have a short prepared statement that I'd like to have entered into the hearing record with your permission.

The CHAIRMAN. It will be.

Mr. RABBE. I am totally unfamiliar with Washington procedures but I know exactly what it takes to maintain a profitable and viable farm. I would just like to say that I'm here on behalf of myself and my neighbors to tell you directly how concerned we are that the farm products exception might be repealed.

In these days of rapidly declining real estate and other farm asset values, many of us have very little equity left to pledge as security for production loans. We are worried that without the farm product exception we will at best be forced to pay a high-risk interest rate and at worst have credit less available to us.

Thank you very much for listening to me and reading my statement.

The CHAIRMAN. You would never be a good politician. You were too brief. [Laughter.]

[The complete prepared statement follows:]

TESTIMONY OF JOHN RABBE, FARMER, TRIMONT, MINNESOTA

Good morning, Mr. Chairman and Members of the Senate Banking Committee. I am pleased to have the opportunity to testify before your Committee on S. 744, a bill to amend the 1981 Food Act to remove the agricultural products mortgage provision. The Committee should be commended for holding this hearing and carefully reviewing this important subject.

My name is John Rabbe, and I am a farmer from Trimont, Minnesota. I operate, with my two sons, a family farm in southwestern Minnesota, and we raise corn and soybeans on 1200 acres of land. In addition, I manage a soybean conditioning business and buy and sell certified seed for farmers in my area. My farm operations and our seed business are both very capital intensive and require considerable amounts of credit.

I have deep concerns about S. 744 and its impact on farm credit. I depend on agricultural credit and understand what this legislative change could mean to farmers, especially marginal farmers, across the country. Further, the potential that production loans could become unsecured and a farmer's credit qualifications could be increased in order to qualify for a loan trouble me greatly. If S. 744 is enacted, I envision higher in interest costs which will reflect the degree of increased risk for agricultural lenders.

Allow me to describe briefly how Minnesota has attempted to deal with this issue in a responsible manner with a new law which became effective July 1, 1985. Under the new provisions, buyers of farm products register for a small fee with the State Department of Agriculture and the information is then transmitted to the local county recorder's office. The County offices then provide lists of buyers at a fee to lenders. Lenders must then notify buyers in the particular counties in which the buyer wishes to purchase agricultural products.

This system has some definite advantages. Buyers are protected from additional financial liability through this system, and if the lender notifies the registered buyers, they are also protected.

Some small buyers have had a few problems in compiling the information supplied by creditors and lenders also believe it is a somewhat cumbersome process. However, while lenders did not request this procedural change in the Minnesota Uniform Commercial Code, this system does provide protection for both buyers and lenders.

Because of the depressed economic conditions in the grain producing area of our country, lenders are already reluctant to lend and a producer would be at a disadvantage if the farm commodity mortgage provision were repealed from state law. Under S. 744, a farmer could not offer his lender good security in the crop for which he is borrowing money to produce.

Once again, thank you Mr. Chairman and Members of the Committee, for holding this hearing. I would be pleased to respond to questions.

The CHAIRMAN. Mr. Rogers.

STATEMENT OF GLENN ROGERS, FARMER, WAHPETON, ND

Mr. ROGERS. Thank you, Senator. I address this committee on behalf of my State and my local bank in North Dakota. I'd like to say too that I support what Senator Andrews said earlier on his statement.

My name is Glenn Rogers and I'm a small farmer, an 1,100-acre farmer, in the southeast corner of North Dakota. I am also in partnership with my dad and we are wheat, barley, soybeans, and corn farmers.

APPLICATIONS FOR FHA LOANS WILL INCREASE

I'm not so familiar with the situation in my local bank but I am very familiar with this situation and what could happen as to the Farmers Home Administration. I am on the county committee which evaluates and approves loan applicants as they come through the county and what this statement was earlier that $5 billion was loaned out through the Farmers Home Administration is going to go down to $4 billion, I can tell you for a fact that in my county alone we've gone from 90 applicants up to we're projecting next year 120. And banks are saying to us we have to shift the risk over to the Farmers Home Administration and the only means of repayment of those loans is through that commodity and to get that money back.

Everyone in this room, everyone of us as taxpayers, I think any of us as we would make a loan to anyone, we would want to be secured of getting something back. There's a saying out there that says, "Farming is everybody's bread and butter." And I think that that statement goes a long way to say what our relationship should be in getting a fair return on the money that is loaned out. The banks could stand a great loss as they would be able to say, OK, we cannot lend to you because you cannot repay and we will turn this over to the Farmers Home Administration or you have to find some other means of financing your crop.

That goes beyond crops. That goes right down to living expenses also. And then where do we stand on that issue also, too.

Farming is a very big business. Lots of money changes hands. We borrow lots of money in the spring and we have a responsibility to repay that. In the Book of Proverbs it says, "The borrower becomes a servant of the lender," and that is so true. But there's also an important part of that that we are given a responsibility to be honest with that lender and say I will repay you plus interest. I think it would be an altogether different farming industry if we could all work without using the bank and just coming in there and probably help him grow by picking up low CD's and notes and that would be great, it would be fun. But right now with the farming economy it isn't working that way and I think we need a second wind for a while and farmers will be working on paying back their operating loans and keeping those communities running.

If one farmer goes under it's going to affect three businesses in a town. That's the grain dealer, the chemical dealer, and the clothes dealer down the street. Those businesses begin to go as the farmer fails.

I'm all in favor of what Senator Andrews mentioned before and I realize that North Dakota is a unique State in the support that it has with the central filing system for these loans. Thank you very much, sir.

The CHAIRMAN. Thank you, Mr. Rogers.

Mr. Johnson.

STATEMENT OF SEYMOUR JOHNSON, FARMER, INDIANOLA, MS; CHAIRMAN, FARM POLICY COMMITTEE, DELTA COUNCIL, ACCOMPANIED BY W.T. ROBERTSON, PRESIDENT, DELTA COUNCIL

Mr. JOHNSON. Mr. Chairman, I am Seymour Johnson, a cotton, cattle, catfish farmer from the Mississippi Delta. I am chairman of the farm policy committee of the Delta Council and I have with me today W.T. Robertson who's the president of the Delta Council. Mr. Robertson is also a cotton, soybean, and rice farmer in our area.

The Delta Council is a voluntary organization of some 5,000 producers in one of the largest agricultural areas of the Nation. We produce some 4 million acres of cotton, soybean, rice, and catfish for a tune of about $1.5 billion.

We come to you today to express our opposition to this amendment. We are deeply concerned that this adds to the burden of an already overburdened Farm Credit System.

I have a prepared statement and rather than read the whole thing I'd just like to paraphrase a few remarks.

OPPOSED TO DELETION OF PRESENT EXCEPTION

One, is Delta Council has been responsible for the last 4 years of having a policy opposing any deletion of the farm products exception from the Uniform Commercial Code. We believe the authors of the Uniform Commercial Code were wise in understanding the unique position of farm products in making this exception. We think that this action or proposed amendment would be unwise, untimely, and insensitive under the present agricultural circumstances.

I can assure you that the removal of farm products exception from the Uniform Commercial Code will not put lenders out of business but instead will put farmers out of business.

I would like to address one item here that I have not heard addressed here today, and that's talking about young farmers. The average farmer in the State of Mississippi is 51 years of age. We're concerned about keeping our young people on the farm and in business. Most young farmers do not own land to offer as collateral. The only collateral they have is the farm product. The same with tenants who own no land but must have just their farm product as collateral. And I think that this amendment would damage the ability of these people to borrow money.

Another segment—how about widows—landlord widows, who are not sophisticated in protecting their interests. You would do away with this protection she presently has and instead she would have to hire an expensive lawyer to follow her lien through on the product.

We would like to point out the Delta Council has been active in passing State legislation in the State of Mississippi where we now have a central data system whereby a buyer by one phone call to the Secretary of State can clear that lien that's outstanding.

There are other options, Senator, to what's being proposed today. We hope that you all will explore those options. Thank you.

[The complete prepared statement follows:]

DELTA Council
PROMOTING AND DEVELOPING THE ECONOMY AND SOCIETY OF ITS AREA
STONEVILLE, MISSISSIPPI 38776

Testimony of Seymour Johnson, Chairman
Farm Policy Committee
Delta Council
Stoneville, Mississippi

Banking, Housing and Urban Affairs Committee
United States Senate

Chairman, Jake Garn

Mr. Chairman and Committee Members,

My name is Seymour Johnson, and I am a cotton, soybean, and catfish farmer from the Mississippi Delta. I currently serve as Chairman of the Farm Policy Committee of Delta Council, a privately supported producer organization from the Mississippi Delta where crops valued in excess of $1 1/2 billion are grown on an annual basis. Also, I have W. I. Robertson with me today, who is a cotton, soybean and rice farmer serving as President of Delta Council this year. Agriculture serves as the base of our economy and the approximately 5,000 member organization of Delta Council represents the agricultural leadership in one of the largest production areas in the country. Cotton, soybeans, rice, wheat, and farm-raised catfish are our principal crops in the production area totalling almost four million acres in our area.

We are deeply grateful to the Chairman and his Committee for allowing us to appear before the Committee today to express our deep concern with regard to the issue being studied by this Committee during this hearing. The issue of collateral interest in crops, as it relates to the availability of farm credit, has never been more prevalent during my lifetime. It is with deep regret that I come before you today, as a farmer, to report that farmers simply cannot afford to abstain from becoming involved in an issue that could contribute toward

FURTHER DETERIORATION OF THE ABILITY OF FARMERS TO OBTAIN CREDIT.

DELTA COUNCIL'S FARM POLICY LEADERSHIP AND THE ENTIRE MEMBERSHIP OF DELTA COUNCIL HAVE ADOPTED POLICY STATEMENTS FOR FOUR CONSECUTIVE YEARS OPPOSING ANY PROPOSAL WHICH WOULD HAVE THE EFFECT OF DELETING THE FARM PRODUCTS EXCEPTION UNDER THE UNIFORM COMMERCIAL CODE. IT IS OUR FIRM BELIEF THAT THE UNIQUE FINANCIAL CREDIT NEEDS OF FARM PRODUCTION WERE FULLY RECGONIZED WHEN THE FARM PRODUCTS EXCEPTION WAS ADOPTED IN THE CODE. SINCE FARM PRODUCTS ARE PRODUCED THROUGH A BIOLOGICAL PRODUCTION CYCLE AND MARKETED IN BULK IN MOST CASES THROUGH A SINGLE TRANSACTION, WE SEE A FUNDAMENTAL DIFFERENCE BETWEEN FARM PRODUCTION AND NON-FARM COMMERCIAL INVENTORY. IN OUR STATE, THE AVERAGE FARM SIZE IS 292 ACRES AND 32 PERCENT OF OUR FARMS HAVE SALES OF LESS THAT $40,000 ANNUALLY. UNLIKE LOANS MADE FOR THE ACQUISITION OF NON-FARM COMMERICAL INVENTORY, PROCEEDS FROM THE SALE OF FARM PRODUCTS ARE NOT TRADITIONALLY REINVESTED IN A REPLACEMENT CROP, BUT RATHER APPLIED TO RETIRE A LOAN WHICH WAS SECURED AT LEAST IN PART BY THE COLLATERAL VALUE OF THAT FARMER'S PRODUCTION. CROPS IN PRODUCTION, STORED CROPS, AND LIVESTOCK REPRESENT THE MAJOR COLLATERAL AND SOURCE OF REPAYMENT OF LOANS FOR FARMERS, AND THEREFORE, WE WOULD OPPOSE ANY CONGRESSIONAL INITIATIVE THAT WOULD RESULT IN REDUCING THE VALUE OF A FARMER'S PRODUCTION AS A SECURITY INTEREST FOR OBTAINING NECESSARY FARM CREDIT

TODAY, FARMERS ARE FACING THE MOST CRITICAL CHALLENGES IN THE PAST HALF OF A CENTURY IN THIS COUNTRY, AND WE FIND IT VERY UNTIMELY AND TOTALLY INSENSITIVE TO THE ECONOMIC CONDITIONS OF AGRICULTURE THAT PROPOSALS WOULD BE SERIOUSLY CONSIDERED AT THIS TIME THAT WOULD CARRY THE POTENTIAL RISK OF ADVERSELY AFFECTING THE AGRICULTURAL LOAN-MAKING DECISION. AS A FARMER FROM THE MISSISSIPPI DELTA, WHICH IS AN AREA SIMILAR TO MOST RURAL AGRICULTURAL AREAS IN THIS COUNTRY, I CAN ASSURE YOU THAT THE REMOVAL OF THE FARM PRODUCTS EXCEPTION FROM THE UNIFORM COMMERCIAL CODE WILL NOT PUT LENDERS OUT OF BUSINESS, BUT WILL INSTEAD PUT MANY FARMERS OUT OF BUSINESS. THE AVERAGE AGE OF FARMERS IN MISSISSIPPI

IS 51 YEARS OLD, AND THE INABILITY OF YOUNG FARMERS TO OBTAIN PRODUCTION FINANCING THROUGH THE TRADITIONAL PRACTICE OF PLACING THE COLLATERAL VALUE OF A CROP AS SECURITY FOR LOAN REPAYMENT WILL UNDOUBTEDLY SERVE AS A DETERRENT FOR OUR YOUNG PEOPLE TO MAINTAIN THE FARMING OPERATIONS THAT THEIR FAMILIES HAVE FARMED FOR MANY YEARS. ALSO, TENANTS WHO RENT THEIR LAND AND HAVE NO OWNERSHIP OF PROPERTY WILL HAVE NO COLLATERAL VALUE TO SUPPORT THEIR FARM CREDIT NEEDS UNDER THE PROPOSED AMENDMENT.

IN CONCLUSION, I WOULD LIKE TO POINT OUT THAT 15 STATES HAVE ENACTED LEGISLATION IN RECENT YEARS THAT RECOGNIZES THE NEED TO PROVIDE ADDITIONAL PROTECTION TO THE BUYERS OF FARM PRODUCTS. DELTA COUNCIL HAS SUPPORTED LEGISLATIVE INITIATIVES IN THE STATE OF MISSISSIPPI IN RECENT YEARS WHICH HAVE RESULTED IN A SYSTEM WHEREBY ALL PURCHASERS CAN IDENTIFY FARM PRODUCT LIENS THROUGH A CENTRAL DATA SYSTEM. WORKING IN COOPERATION WITH OUR STATE OFFICIALS, WE HAVE BEEN ASSURED THAT ALL BUYERS OF AGRICULTURAL PRODUCTS IN THE STATE OF MISSISSIPPI WILL HAVE THE AVAILABILITY OF ACCURATE RECORDS IDENTIFYING ALL SECURITY INTEREST IN A CROP THROUGH THE PROPOSED PLAN THAT WAS OFFERED THROUGH THESE LEGISLATIVE INITIATIVES. SINCE IT HAS BEEN DEMONSTRATED THAT THERE ARE OTHER OPTIONS TO ADDRESS THIS PROBLEM RATHER THAN COMPLETELY REMOVING THE FARM PRODUCTS EXCEPTION TO THE UNIFORM COMMERCIAL CODE, I WOULD CLOSE BY STATING THAT THE FRAGILE FINANCIAL CONDITION OF AMERICAN AGRICULTURE OFFERS AMPLE TESTIMONY TO ADEQUATELY SUPPORT THE NEED FOR CONGRESS TO EXHAUST EVERY OPTION PRIOR TO ENACTING ANY LEGISLATION THAT WOULD THREATEN THE FUNDAMENTAL LOAN-MAKING DECISION FOR FARM PRODUCTION.

WE GENUINELY APPRECIATE THE COMMITTEE ALLOWING DELTA COUNCIL TO APPEAR BEFORE YOU TODAY.

RESPECTFULLY SUBMITTED,
SEYMOUR B. JOHNSON

The **Chairman**. Thank you, Mr. Johnson. You made a comment that's been made several times today that the farmers will go out of business, not the bankers. How do you separate it? The reason there is $6 billion of loans or the reason there are so many banks on the troubled list in the agricultural community and the farm credit is because farmers are in trouble. I don't know how to separate agricultural banks from agricultural producers. That's why I made the point over and over again you're in this together and as long as we have those kinds of divisions can you separate them? If massive numbers of farmers are going under, the banks that loaned them money are going with them.

So is that an accurate statement, to say that it's only the farmers that will go under? I look at the figures and those curves are the same. The farmers and the farm bankers are in this trouble together.

Mr. **Johnson**. Well, I agree with you, sir, because a banker that looks at a loan and he's now got a questionable loan about a risky business and he now knows that his collateral is in jeopardy is not as likely to make that loan. I agree with you.

TWO SIDES TO THE EQUATION

The **Chairman**. That's what I'm trying to drive at in coming to a solution. I don't disagree with any of you who want to do away with the exemption and get away from double jeopardy. I don't disagree with that. But not at the expense of the other side of the equation.

Basically what we're hearing is we're hearing two sides, and you're in this problem together. At least that's my opinion. And it's got to be worked out together rather than just coming to Congress and saying we're opposed and we're for. I don't think that's going to solve the problem.

Mr. **Robertson**. Senator, I'm W.T. Robertson. I understand the meat people's problem. They have a 24-hour problem. I don't think we need to change the law on a 24-hour problem. We sell our catfish to a processing plant and we're lucky to get a check for 2 weeks to 30 days, and we're looking at new ways to solve these problems.

How about the credit card industry? They can check a lien or an overcharge on a credit card in 5 minutes. So I think we're getting automated enough that these liens can be checked. How many millions of people have credit cards, and you try to buy something over a limited credit card and they can take care of you in 3 minutes.

The **Chairman**. Mr. White, let me ask you a question. I know you want to respond anyway. Has there been any meetings—and I would ask Mrs. Smith the same question—between the cattlemen and the Farm Bureau and the banking organizations to try to come up with some joint solutions?

Mr. **White**. Well, obviously, yes. In response to your question, that's what has happened in Illinois and how we have developed the law the way we have in Illinois. Again, I would say it's been a very workable law and is one that has worked very well with all three parties.

I think a point we've been overlooking, quite in reverse of the last statement, is the fact that this system is a very efficient, cost-effective system and we're all looking for efficiencies—the lender, the borrower, the farmer, whoever, seller. And in this system the bank knows those areas where his problems are generally—should know—and he can serve that notification to the prospective buyers and avoid massive notification, if you will, of all the buyers.

The credit card system was mentioned and so was the central filing system; those are very expensive systems. We know what we pay in the credit card industry today in the way of interest carrying costs as an example of how expensive that system can be. So I certainly hope that we look at an efficient system and not a bureaucratic nightmare.

The CHAIRMAN. You're president of the Illinois Farm Bureau, but you're representing the American Farm Bureau today. Why can't what has been done in Illinois be expanded to the national bases so you can come in here with a cooperative opinion?

USE ILLINOIS SYSTEM AS BASIS FOR COOPERATION

Mr. WHITE. I guess that we're using this forum today as part of that cooperative opinion, if you will, recognizing that individual States can't say to another State you do this or you do that. The Feds have to do that and so as far as your organizational getting together, we do that all the time. The cattlemen and myself had breakfast together this morning and were debating this issue and the national leaders have met many times on this issue in the past.

The CHAIRMAN. But apparently there has been no success then because there was unified opposition from all of the farm groups to the Banking Committee even holding hearings. Don't worry about the fact we have some jurisdiction in this committee by act of Congress over the financial institutions and the Farm Credit System and all of that, they didn't even want us to hear it.

Mr. WHITE. I think what's happened in Illinois and the way we brought about the law in Illinois was to have all the groups and entities get together and decide what was best for the industry as a whole, and we've seemed to have developed what appears to be a very workable law and I guess it would be proper to say for your committee to offer this as a type of a workable solution nationally, at your discretion.

The CHAIRMAN. Mrs. Smith, have the cattlemen attempted to compromise on this issue?

Mrs. SMITH. Mr. Chairman, let me state that we recognize the need for compromise in a solution. We also recognize the need to represent our industry. But we know that in States such as Illinois and California where these laws have been in effect and have a track record that the credit in those States is not the issue at hand, so we know it's working. But we can assure you that the National Cattlemen's Association stands ready to work with other commodity groups and this committee and the Agriculture Committee to make a solution that is workable.

The CHAIRMAN. OK. Everybody stands ready. Who's been holding meetings? Who's going to initiate it? Who's going to make the calls? Let's put this on the record, too. When I initially talked about jurisdiction, I have never had more threatening calls in my political career than came from the National Cattlemen's Association about wanting my home phone number—they were just going to beat me to death with calls and lobbying, and so on. Well, that doesn't work with Jake Garn. That made me all the more determined to hold hearings. But there has been a game going on for some months. There's been an unwillingness to talk about this issue and try and compromise it. And I don't like that—totally apart from the substance of the issue—once again, I agree with you. I don't like double jeopardy. But from a group that has normally been a very good friend of mine, certainly the Utah Cattlemen's Association understands me and where I'm coming from. There was a very desperate campaign going on by some of the farm groups to even prevent us from holding this hearing.

When there's an attempt to even keep a committee from holding a hearing, there is something terribly, terribly wrong with that.

So the words sound good, but I'm saying again, I think people ought to start talking to each other before they run to Congress and beg for imposing solutions without regard to the other side of the coin, particularly when you can't separate those two sides of the coin. And you're all kidding yourselves—both sides—I'm not just talking to you as farmers or representing agriculture, but bankers too. If you fight for your own position you're both going to lose either way because you can't separate agricultural credit from the performance of agriculture. You've got to have finance. You've got to have viable institutions. You can't put them in jeopardy and they shouldn't be putting you in double jeopardy.

GRUDGING CONCESSIONS TO EACH OTHER

Now what I'm saying is I'd like to see you all go back and see if you can talk to each other and come back to Congress with some workable solutions, rather than abandoning all your normal free enterprise and saying, let's run to Washington and get a solution imposed across the country. I'm even willing to do that. I'm even willing to preempt State law if you'll come up with some grudging concessions to each other that will help both sides. I'll promise you a few years down the road you'll be better off, a lot better off, just like the realtors and the S&L's are because they grudgingly came together and worked something out that was beneficial to both sides.

Mrs. **Smith**. Mr. Chairman, let me assure you, as president of the National Cattlemen's Association, we are certainly willing to do our part. As president, I will commit that to you in communicating and working with—because we do need financial sources. We don't need banks to go out. We know that.

The **Chairman**. Well, will you call and initiate a meeting to talk about it with some of the groups on the other side?

Mrs. **Smith**. Sure, I will.

The **Chairman**. Mr. Rogers.

Mr. **Rogers**. I think you're dealing with quite a large sector of individuals in the farmer and one thing the farmer probably doesn't want to do is tell somebody else what his financial condition is, and that's what he's doing when he's telling the elevator or some other institution that's buying his commodity that he doesn't have free and clear title to that product. And that works on the individual pretty hard, especially in hard times, and if you're asking for a solution, I think the bankers and people like that can sit down with the farmer and say, all right, we understand where you're at but you have to understand our view too, and we need that money back plus interest to keep this business going. How about if you just tell us who you're going to be selling to and we'll just send a letter out so we get our part of our money back too.

The **Chairman**. Thank you all very much. It is a difficult issue, but I can't sit back in this position and see 6 billion dollars' worth of defaults and the agricultural banking system going down the tube without attempting to help solve that problem as well. So my plea is very sincere and earnest to try and work this out to see if we can come up with a compromise. The best compromises I've ever seen is when nobody likes them but they will grudgingly accept. That means everybody has given a little bit and didn't get their own way, but it's better for the overall situation.

Thank you very much for coming.

Our final panel is Mr. Bill Brandt, general counsel, Nebraska Bankers Association; and Dan Gunderson, executive vice president, Minnesota Agri-Growth Council.

Mr. Brandt, please go ahead.

STATEMENT OF WILLIAM B. BRANDT, GENERAL COUNSEL, NEBRASKA BANKERS ASSOCIATION

Mr. **Brandt**. Mr. Chairman, my name is William Brandt and I'm here today as general counsel representing the Nebraska Bankers Association, Inc., a trade association representing 458 of the 463 commercial banks in Nebraska. As you are aware, Nebraska is a highly agricultural livestock intensive State and is suffering severe stress as the result of the recent economic recessions compounded by additional immediate past losses due to drought and flood.

We, by the way, have between 15 and 18 failed agricultural banks in the past 2 years. In addition to my official capacity representing the Nebraska Bankers Association, I am a farm owner. I have tenant farmers. I feel that I am able to view the problems that have been presented from an objective point of view as opposed to just strictly a legal point of view.

LACK OF UNDERSTANDING AND KNOWLEDGE

The problem has been in Nebraska for a number of years and it's received a great deal of attention and in trying to determine a solution we looked of course to the causes. And in addition to the stresses that I have just mentioned, we found that there was a great lack of understanding and knowledge in the operation of the present notice system in other industries and a failure to comprehend the tremendous importance of the integrity and reliability of the farm product lien established under the Uniform Commercial Code. There was also a tremendous resistance to attempt to learn about this particular facet.

I speak in opposition to S. 744 and any other Federal preemption of the Uniform Commercial Code section 9-307, the farm products exception, which is referred to as clear title or double jeopardy provisions of the code. This is notwithstanding the fact that we have participated in and are willing and have been willing and will continue to be willing to enter into negotiations and compromises in finding a total solution to the problem.

But at this critical time in the lives of many Nebraskans and other farmers, we must be very careful so that in the guise of providing an easier way for some members of our business community to transact business or to provide an economic benefit to other businessmen, that we do not inadvertently destroy the basis upon which most farm credit today is predicated.

Let me say very clearly, there is no such thing as a clear title or double jeopardy problem under section 9-307 of the Uniform Commercial Code, which has been the law subject to a few recent exceptions of all but one State for many years. As a matter of fact, the code simply restates the law in regard to the purchase of farm products as has existed for many years prior to the Uniform Commercial Code in most States.

Back to clear title. All one has to do for maximum protection in the purchase of farm products is to check under the notice provision of the Uniform Commercial Code in a similar manner as every lender must do to perfect a lien priority in the first place. One of the basic tenets of a code lien is notice to the world, which is commonly referred to as the perfection, which, when coupled with the agreement of the borrower in writing that a lien will attach, provides a perfected lien that establishes a priority upon which the world can rely. No one who has bothered to check properly—and this includes the great majority of the purchasers of farm products—has ever lost a dime.

We hear the arguments that buyers of farm products are treated differently. Ms. Lawrence addressed that issue. Let's examine the facts. As you are aware, one of the purposes of the code in the first place was to provide an economic atmosphere that would allow a maximum of credit and a maximum of a free-flow of commercial transactions. Prior to the adoption of the code there was extreme difficulty with liens on inventory, with liens on after-acquired property or on crops to be grown. Exact descriptions were required to keep from having a lien defeated. This applied to everybody—farmers, merchants and all segments of our economy. The framers of the code searched for and found new ways to provide additional security for additional type loans and additional type credit, especially in the area of inventory liens. In the case of most business inventories it was necessary that protections be established, which was done by providing severe sanctions in the event the merchant disposed of all or the greater portion of his inventory without complying with the strict creditor notification and protection procedures. This protection was developed in article 6 of the code and known as the bulk transfers.

It was also obvious that it was necessary that a purchaser of a single item of that inventory had to have assurances that he could purchase free of a lien. Farm products normally have the characteristics of inventory. In fact, the code calls them inventory if they leave the possession of the producer and are not sold. The framers of the code left the old rule, the law of many years, in place which only required that a buyer check to see if someone else might not have an interest in the farm product.

There is a vast difference between an individual buying one fan or one refrigerator from a merchant and the grain elevator or packer that buys a farmer's complete or greater part of his inventory.

FAVORED TREATMENT OF LIVESTOCK MARKETS IN NEBRASKA

Let's for the moment address the issue of purchasers of farm products other than grain buyers. Livestock markets in Nebraska have a highly favored treatment in that they may sell free of the lien so long as they announce the name and address of the owner of the livestock prior to the sale. Most do not choose to do this and elect instead to insure against a possible loss. Processing markets have an even better opportunity to check than most. While I understand that most processors prefer to insure, it would seem that the Nebraska practice of viewing the livestock in the owner's lot on one or more occasions prior to the sale would afford ample opportunity to check the record prior to consummating the purchase.

S. 744 provides, among other things, that there must be reported any payment obligation imposed on the buyer by the secured party as a condition for waiver and release of the security interest. I can see a tremendous increase in litigation just to sort out the waiver by a course of conduct, which is a separate issue but which is rising to the fore throughout the Midwest and in the Farm Belt States. This provision alone will proliferate the dissemination of secured debtors names and would create a paper blizzard of names in the hands of every potential purchaser. And you can visualize what would occur in southeast Nebraska where there are probabely 150 to 170 potential markets within a radius of 75 to 100 miles.

What we then have is a minicentral filing system in the hands of each buyer of farm products without the assurances and protections of existing notification systems.

Shifting the burden of notification to the farmer does not solve the problem that has been alluded to often today. And in the event of default, his loan remains unpaid and uncollected.

It is very obvious upon examination of the facts that the only real protection a lender would have in the event this provision becomes law would be to withhold credit. If lenders are not able to secure their loans for livestock, seed, fertilizer, fuel, chemicals, and irrigation expenses, with the product that is a result of these loans and to be able to rely thereon, it follows that the loans will not be made. It is also obvious, and this is conservative, that from 5 to 10 percent of the farmers, amounting to a withdrawal from the economy of hundreds of millions of dollars, if not billions, would be denied credit who otherwise would be deserving in order that lenders could adequately protect their portfolios. This, by the way, would naturally hit hardest the young farmer and the farmer who is already having a difficult time, the very people to whom most of the effort today is being directed to assist in keeping agriculture a viable life form.

There is even a greater reason that a solution be found to our so-called double jeopardy or clear title concern which affects agricultural lenders and others. We are aware that some buyers of farm products have also expanded their business and services, not only to furnishing feed and fertilizer but to the furnishing of a much wider list of products, including veterinary products, groceries and many others. These products and services are often advanced during the summer months without adequate arrangements for payment and they, the people that advance the money or advance the product, as everyone else who has an interest in the farmer's product, undoubtedly are looking to the same source for payment as the lender is looking for repayment. Should a purchaser of farm products be enabled to acquire clear title notwithstanding any previous liens—and that would include petroleum liens, fertilizer liens, and Uniform Commercial Code liens—nothing would prevent that purchaser from setting off his debt under the common law against the proceeds of that crop, thereby creating an undisclosed lien of greater magnitude and authority than anything that could be created by law.

DEVELOPMENT OF A CENTRAL INDEXING SYSTEM

There are some curable problems that have developed with some of our present notice systems, such as lack of filing officer cooperation in providing access to information and a lag time in filing because of sheer volume. The Nebraska Legislature has directed the development of a central indexing system available 24 hours a day and accessible by nearly any communication means, including computer access. The basic documents would remain on file for inspection much in the same manner as has been done over the years, maintaining the integrity of the county filing officer. This is a workable solution as, if we are to survive in our rural environment, we all must become more sophisticated and be willing to enter into the 21st century together with each bearing a share of the responsibility of making our society work.

The Nebraska approach has represented hundreds of hours of give and take and even as an interim solution has a number of advantages. It is entirely voluntary on the part of the purchaser and the action of a lender. It relies to some extent on the basic honesty of the farmer. And has been primarily an experience that has brought the buyer, the seller, and the lender together to discuss terms before the marketplace has even become an issue, which is what should have happened in the first place.

This is obviously a local issue which would be best solved through State by State attention, and it necessarily follows that S. 744 should progress no further.

To do away with the many hundreds of hours of effort to solve this problem at the State level by Federal preemption would almost be unthinkable.

[The complete prepared statement follows:]

OCTOBER 9, 1985

TESTIMONY OF WILLIAM B. BRANDT, GENERAL COUNSEL, REPRESENTING THE NEBRASKA BANKERS ASSOCIATION, BEFORE THE SENATE BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE IN OPPOSITION TO S.744, THE FEDERAL PREEMPTION OF THE UNIFORM COMMERCIAL CODE IN REPEALING THE FARM PRODUCTS EXEMPTION UNDER UCC SECTION 9-307.

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE, MY NAME IS WILLIAM B. BRANDT AND I APPEAR TODAY AS GENERAL COUNSEL REPRESENTING THE NEBRASKA BANKERS ASSOCIATION, INC., A TRADE ASSOCIATION REPRESENTING 458 OF THE 463 COMMERCIAL BANKS IN NEBRASKA. AS YOU ARE AWARE, NEBRASKA IS A HIGHLY AGRICULTURAL-LIVESTOCK INTENSIVE STATE AND IS SUFFERING SEVERE STRESS AS THE RESULT OF THE RECENT ECONOMIC RECESSION COMPOUNDED BY ADDITIONAL IMMEDIATE PAST LOSSES DUE TO DROUGHT AND FLOOD.

AS A RESULT OF THESE STRESSES, WHICH HAVE EFFECTED ALL PARTS OF THE NEBRASKA ECONOMY, LENDERS WERE CONFRONTED BY DIFFERENT PURCHASERS OF FARM PRODUCTS, LED PRINCIPALLY BY THE FEED AND GRAIN, LIVESTOCK INDUSTRY AND COOPS. THEY HAD BEGUN TO LOOK AT THE EFFECT OF UCC SECTION 9-307 IN THE LIGHT OF THE WAY THEY HAD BEEN DOING BUSINESS FOR YEARS. WE ATTEMPTED TO ESTABLISH DIALOGUE AND UNDERSTAND SOME OF THEIR CONCERNS ESPECIALLY WHEN FACED WITH COMPLETE REPEAL OF SECTION 9-307. WE FOUND A GREAT LACK OF UNDERSTANDING AND KNOWLEDGE OF OPERATION OF THE PRESENT NOTICE SYSTEM IN OTHER INDUSTRIES AND A FAILURE TO COMPREHEND THE TREMENDOUS IMPORTANCE OF THE INTEGRITY AND RELIABILITY OF THE FARM PRODUCT LIEN ESTABLISHED UNDER THE UNIFORM COMMERCIAL CODE. WE ALSO FOUND SOME LOCAL REMEDIAL PROBLEMS WITH THE OPERATION OF THE PRESENT NOTIFICATION SYSTEM.

THE NEBRASKA COMPROMISES REPRESENTED AN INTERIM SOLUTION WHEREBY VOLUNTARY COOPERATION ON THE PART OF PURCHASERS OF FARM PRODUCTS WITH EACH INDUSTRY (INCLUDING LENDERS) ACCEPTING A SMALL AMOUNT OF ADDITIONAL RESPONSIBILITIES PROVIDED THE MAINTENANCE OF THE INTEGRITY OF THE 9-307 LIEN UNTIL A FULL CENTRAL INFORMATION SYSTEM IS IN PLACE, THEREBY PRESERVING HUNDREDS OF MILLIONS OF DOLLARS OF CREDIT FOR OUR MANY DISTRESSED BUT DESERVING FARMERS.

I SPEAK IN OPPOSITION TO S.744, AND ANY OTHER FEDERAL PREEMPTION OF THE UNIFORM COMMERCIAL CODE SECTION 9-307, FARM PRODUCTS EXCEPTION, SOMETIMES REFERRED TO AS THE "CLEAR TITLE" OR "DOUBLE JEOPARDY" PROVISION OF THE CODE.

AT THIS CRITICAL TIME IN THE LIVES OF MANY NEBRASKA AND OTHER FARMERS, WE MUST BE VERY CAREFUL SO THAT IN THE GUISE OF PROVIDING AN EASIER WAY FOR SOME MEMBERS OF OUR BUSINESS COMMUNITY TO TRANSACT BUSINESS OR TO PROVIDE AN ECONOMIC BENEFIT TO OTHER BUSINESSMEN, THAT WE DO NOT INADVERTENTLY DESTROY THE BASIS UPON WHICH MOST FARM CREDIT IS TODAY PREDICATED.

LET ME SAY VERY CLEARLY, THERE IS NO SUCH THING AS A CLEAR TITLE OR DOUBLE JEOPARDY PROBLEM UNDER SECTION 9-307 OF THE UNIFORM COMMERCIAL CODE, WHICH HAS BEEN THE LAW SUBJECT TO A FEW RECENT

EXCEPTIONS OF ALL BUT ONE STATE FOR MANY YEARS. AS A MATTER OF FACT, THE CODE SIMPLY RESTATES THE LAW IN REGARD TO THE PURCHASE OF FARM PRODUCTS AS HAS EXISTED FOR MANY YEARS PRIOR TO THE UNIFORM COMMERCIAL CODE IN MOST STATES.

BACK TO "CLEAR TITLE". ALL ONE HAS TO DO FOR MAXIMUM PROTECTION IN THE PURCHASE OF FARM PRODUCTS IS TO CHECK UNDER THE NOTICE PROVISION OF THE UNIFORM COMMERCIAL CODE IN A SIMILAR MANNER AS EVERY LENDER MUST DO TO PERFECT A LIEN PRIORITY IN THE FIRST PLACE. ONE OF THE BASIC TENETS OF A UNIFORM COMMERCIAL CODE LIEN IS NOTICE TO THE WORLD, WHICH IS COMMONLY REFERRED TO AS THE PERFECTION, WHICH, WHEN COUPLED WITH THE AGREEMENT OF THE BORROWER IN WRITING THAT A LIEN WILL ATTACH PROVIDES A PERFECTED LIEN THAT ESTABLISHES A PRIORITY UPON WHICH THE WORLD CAN RELY. NO ONE WHO HAS BOTHERED TO CHECK PROPERLY (AND THIS INCLUDES THE GREAT MAJORITY OF THE PURCHASERS OF FARM PRODUCTS) HAS EVER LOST A DIME.

WE HEAR THE ARGUMENTS THAT BUYERS OF FARM PRODUCTS ARE SOMEHOW TREATED DIFFERENTLY. LET'S EXAMINE THE FACTS. AS YOU ARE AWARE ONE OF THE PURPOSES OF THE UNIFORM COMMERCIAL CODE WAS TO PROVIDE AN ECONOMIC ATMOSPHERE THAT WOULD ALLOW A MAXIMUM OF CREDIT AND A MAXIMUM OF A FREE-FLOW OF COMMERCIAL TRANSACTIONS. PRIOR TO THE ADOPTION OF THE CODE THERE WAS EXTREME DIFFICULTY WITH LIENS ON INVENTORY, WITH LIENS ON AFTER-ACQUIRED PROPERTY OR ON CROPS TO BE GROWN. EXACT DESCRIPTIONS WERE REUQIRED TO KEEP FROM HAVING A LIEN DEFEATED. THIS APPLIED TO EVERYONE, FARMERS, MERCHANTS AND ALL SEGMENTS OF OUR ECONOMY. THE FRAMERS OF THE CODE SEARCHED FOR AND FOUND NEW WAYS TO PROVIDE SECURITY FOR

ADDITIONAL LOANS ESPECIALLY IN THE AREA OF INVENTORY LIENS. IN THE CASE OF MOST BUSINESS INVENTORIES IT WAS NECESSARY THAT PROTECTIONS BE ESTABLISHED, WHICH WAS DONE BY PROVIDING SEVERE SANCTIONS IN THE EVENT THE MERCHANT DISPOSED OF ALL OR THE GREATER PORTION OF HIS INVENTORY WITHOUT COMPLYING WITH STRICT CREDITOR NOTIFICATION AND PROTECTION PROCEDURES. THIS PROTECTION WAS DEVELOPED IN ARTICLE 6 OF THE CODE, BULK TRANSFERS.

IT WAS ALSO OBVIOUS THAT IT WAS NECESSARY THAT A PURCHASER OF A SINGLE ITEM OF THAT INVENTORY HAD TO HAVE ASSURANCES THAT HE COULD PURCHASE FREE OF A LIEN. FARM PRODUCTS NORMALLY HAVE THE CHARACTERISTICS OF INVENTORY (IN FACT THE CODE CALLS THEM INVENTORY IF THEY LEAVE THE POSSESSION OF THE PRODUCER AND ARE NOT SOLD). THE FRAMERS OF THE CODE LEFT THE OLD RULE, THE LAW OF MANY YEARS, IN PLACE WHICH ONLY REQUIRED THAT A BUYER CHECK TO SEE IF SOMEONE ELSE MIGHT NOT HAVE AN INTEREST IN THE FARM PRODUCT.

THERE IS A VAST DIFFERENCE BETWEEN AN INDIVIDUAL BUYING ONE FAN OR ONE REFRIGERATOR FROM A MERCHANT AND THE GRAIN ELEVATOR THAT BUYS A FARMER'S COMPLETE OR GREATER PART OF HIS INVENTORY.

THE FRAMERS OF THE CODE WERE GIVEN ANOTHER OPPORTUNITY TO ADDRESS THE ISSUES PRESENTED BY S.744 WHEN THE COMMISSIONERS ON UNIFORM STATE LAWS PREPARED AND PROPOSED THE 1972 AMENDMENTS TO THE CODE, WHICH HAVE BEEN ADOPTED BY MOST STATES. AGAIN, THE SPECIFIC ISSUE OF THE BUYER OF FARM PRODUCTS UNDER 9-307 WAS CONSIDERED AND REJECTED AS DETRIMENTAL TO LENDING.

LET'S FOR THE MOMENT DISCUSS PURCHASERS OF FARM PRODUCTS OTHER THAN GRAIN BUYERS. LIVESTOCK MARKETS IN NEBRASKA HAVE A HIGHLY FAVORED TREATMENT IN THAT THEY MAY SELL FREE OF THE LIEN SO LONG AS THEY ANNOUNCE THE NAME AND ADDRESS OF THE OWNER OF THE LIVESTOCK PRIOR TO THE SALE. MOST DO NOT CHOOSE TO DO THIS AND ELECT INSTEAD TO INSURE AGAINST A POSSIBLE LOSS. PROCESSING MARKETS HAVE EVEN A BETTER OPPORTUNITY TO CHECK THAN MOST. WHILE I UNDERSTAND THAT MOST PROCESSORS PREFER TO INSURE, IT WOULD SEEM THAT THE NEBRASKA PRACTICE OF VIEWING THE LIVESTOCK IN THE OWNER'S LOT ON ONE OR MORE OCCASIONS PRIOR TO THE SALE WOULD AFFORD AMPLE OPPORTUNITY TO CHECK THE RECORD PRIOR TO CONSUMMATING THE PURCHASE.

LET'S EXAMINE THE PRESENT PROPOSAL AND DISCOUNT FOR THE MOMENT THAT ITS PROPONENTS WOULD HAVE HAD YOU BUY IT CART BLANCHE WITHOUT THE COURTESY OF A PUBLIC HEARING AND LEGISLATIVE SAFEGUARD.

IT IS HIGHLY TOUTED AS "SOMETHING FOR THE FARMER". WHAT DOES IT DO? IT REQUIRES FOR EVEN A MODICUM OF PROTECTION FOR THE LENDER THAT IT NOTIFY EVERY PROSPECTIVE PURCHASER INCLUDING COMMISSION MERCHANTS OF THE FARM PRODUCTS:

1. THE SECURITY INTEREST INCLUDING BUT NOT LIMITED TO
    - A. THE NAME AND ADDRESS OF THE SECURED PARTY:
    - B. THE NAME AND ADDRESS OF THE SELLER
    - C. A REASONABLE DESCRIPTION OF THE PROPERTY, INCLUDING THE JURISDICTION (WHATEVER THAT IS) WHERE THE PROPERTY IS LOCATED (SOME FARMERS FARM IN 3 OR MORE COUNTIES), AND
    - D. ANY PAYMENT OBLIGATION IMPOSED ON THE BUYER BY THE SECURED PARTY AS A CONDITION FOR WAIVER AND RELEASE OF THE SECURITY INTEREST.

I CAN SEE A TREMENDOUS INCREASE IN LITIGATION JUST TO SORT OUT "WAIVER" BY A COURSE OF CONDUCT (WHICH IS A SEPARATE ISSUE). THIS PROVISION ALONE IS DESIGNED TO PROLIFERATE THE DISSEMINATION OF SECURED DEBTORS NAMES AND WOULD CREATE A BLIZZARD OF PAPER AND NAMES IN THE HANDS OF EVERY POTENTIAL PURCHASER. WHAT WE THEN HAVE IS A MINI-CENTRAL FILING SYSTEM IN THE HANDS OF EACH BUYER OF FARM PRODUCTS WITHOUT THE ASSURANCES AND PROTECTIONS OF EXISTING NOTIFICATION SYSTEMS.

IF THIS WERE NOT ENOUGH, THE AMENDMENT, WHICH I AM INFORMED WAS DRAFTED BY THE PROPONENTS WITHOUT THE CONSULTATION OF THE ABA OR OTHER LENDING GROUPS AND FURTHER DEGRADES OUR FARMER CUSTOMER BY REQUIRING THAT THE LENDER MAY INSERT INTO THE SECURITY AGREEMENT LANGUAGE REQUIRING UNDER THE PENALTIES OF A $5,000 FEDERAL FINE TO THE CUSTOMER -

1. THE SELLER IS OBLIGATED TO FURNISH THE SECURED PARTY A LIST OF PERSONS TO WHOM THE SELLER WILL SELL THE PRODUCT
2. THE SECURED PARTY IS THEN OBLIGATED TO GIVE THE NOTICES AS SPECIFIED ABOVE
3. THE FARMER MUST UPDATE THE LIST WITHIN 7 DAYS OF THE SALE OR ACCOUNT FOR THE PROCEEDS WITHIN 10 DAYS OF THE SALE OR BE SUBJECT TO THE $5,000 FINE.

THIS HAS THE PRACICAL EFFECT OF DEPRIVING OUR FARMER CUSTOMER OF PROPERTY WITHOUT DUE PROCESS OF LAW AND THEREFORE, CONSTITUTIONALLY SUSPECT IN NOT ALLOWING HIM COMPLETE FREEDOM IN CHOOSING HOW AND WHEN HIS CROP WILL BE DISPOSED. ONE MIGHT WONDER WHAT DETERRENT $5,000 MIGHT BE IF A GREAT AMOUNT OF COLLATERAL WAS INVOLVED. SHIFTING OF THE BURDEN OF NOTIFICATION

TO THE FARMER DOES NOT SOLVE THE PROBLEM IN THE EVENT OF DEFAULT. HIS LOAN REMAINS UNPAID AND UNCOLLECTED.

IT IS VERY OBVIOUS UPON EXAMINATION OF THE FACTS THAT THE ONLY REAL PROTECTION A LENDER WOULD HAVE IN THE EVENT THIS PROVISION BECOMES LAW WOULD BE TO WITHHOLD CREDIT. IF LENDERS ARE NOT ABLE TO SECURE THEIR LOANS FOR LIVESTOCK, SEED, FERTILIZER, FUEL, CHEMICALS AND IRRIGATION EXPENSES, WITH THE PRODUCT THAT IS A RESULT OF THESE LOANS AND TO BE ABLE TO RELY THEREON, IT FOLLOWS THAT THE LOANS WILL NOT BE MADE. IT IS ALSO OBVIOUS, AND THIS IS CONSERVATIVE, THAT FROM 5% TO 10% OF THE FARMERS, AMOUNTING TO A WITHDRAWAL FROM THE ECONOMY OF HUNDREDS OF MILLIONS OF DOLLARS, IF NOT BILLIONS, WOULD BE DENIED CREDIT WHO OTHERWISE WOULD BE DESERVING, IN ORDER THAT LENDERS COULD ADEQUATELY PROTECT THEIR PROTFOLIOS. THIS, BY THE WAY, WOULD NATURALLY HIT HARDEST THE YOUNG FARMER AND THE FARMER WHO IS ALREADY HAVING A DIFFICULT TIME, THE VERY PEOPLE TO WHOM MOST OF THE EFFORT TODAY IS BEING DIRECTED TO ASSIST IN KEEPING AGRICULTURE A VIABLE LIFE FORM.

THERE IS AN EVEN GREATER REASON THAT A SOLUTION BE FOUND TO OUR SO CALLED DOUBLE JEOPARDY CONCERN, WHICH AFFECTS AG LENDERS AND OTHERS. WE ARE AWARE THAT SOME BUYERS OF FARM PRODUCTS HAVE ALSO EXPANDED THEIR BUSINESS AND SERVICES, NOT ONLY TO FURNISHING FEED AND FERTILIZER BUT TO THE FURNISHING OF A MUCH WIDER LIST OF PRODUCTS, INCLUDING VETERINARY PRODUCTS AND MANY OTHERS. THESE PRODUCTS AND SERVICES ARE OFTEN ADVANCED DURING THE SUMMER MONTHS WITHOUT ADEQUATE ARRANGEMENTS FOR PAYMENT AND THEY, AS EVERYONE ELSE WHO HAS AN INTEREST IN THE FARMERS PRODUCT, ARE UNDOUBTEDLY LOOKING TO THE SAME SOURCE FOR PAYMENT AS THE LENDER IS LOOKING FOR REPAYMENT. SHOULD A PURCHASER OF FARM PRODUCTS BE ENABLED TO ACQUIRE CLEAR TITLE NOTWITHSTANDING ANY PREVIOUS LIENS, I.E., PETROLEUM LIENS, FERTILIZER LIENS AND UNIFORM COMMERCIAL CODE LIENS, NOTHING WOULD PREVENT THAT PURCHASER FROM SETTING OFF HIS DEBT UNDER THE COMMON LAW AGAINST THE PROCEEDS OF THAT CROP, THEREBY CREATING AN UNDISCLOSED LIEN OF GREATER MAGNITUDE AND AUTHORITY THAN ANYTHING THAT COULD BE CREATED BY LAW.

THERE ARE SOME CURABLE PROBLEMS THAT HAVE DEVELOPED WITH SOME OF OUR PRESENT NOTICE SYSTEMS, SUCH AS LACK OF FILING OFFICER COOPERATION IN PROVIDING ACCESS TO INFORMATION AND A LAG TIME IN FILING BECAUSE OF SHEER VOLUME. THE NEBRASKA LEGISLATURE HAS DIRECTED THE DEVELOPMENT OF A CENTRAL INDEXING SYSTEM AVAILABLE 24 HOURS A DAY AND ACCESSIBLE BY NEARLY ANY COMMUNICATION MEANS INCLUDING COMPUTER ACCESS. THE BASIC DOCUMENTS WOULD REMAIN ON FILE FOR INSPECTION MUCH IN THE SAME MANNER AS HAS BEEN DONE OVER THE YEARS. THIS IS A WORKABLE SOLUTION AS, IF WE ARE TO SURVIVE IN OUR RURAL ENVIRONMENT, WE ALL MUST BECOME MORE SOPHISTICATED AND BE WILLING TO ENTER INTO THE 21ST CENTURY TOGETHER WITH EACH BEARING A SHARE OF THE RESPONSIBILITY OF MAKING OUR SOCIETY WORK.

THE NEBRASKA APPROACH HAS REPRESENTED HUNDREDS OF HOURS OF GIVE AND TAKE, AND EVEN THOUGH AN INTERIM SOLUTION HAS A NUMBER OF ADVANTAGES:

1. IT IS ENTIRELY VOLUNTARY ON THE PART OF THE PURCHASER
2. IT RELIES TO SOME EXTENT ON THE BASIC HONESTY OF THE FARMER
3. IT HAS BROUGHT THE BUYER, THE SELLER AND THE LENDER TOGETHER

TO DISCUSS TERMS BEFORE THE MARKETPLACE HAS EVEN BECOME AN ISSUE, WHICH IS WHAT SHOULD HAVE BEEN HAPPENING IN THE FIRST PLACE.

THIS IS OBVIOUSLY A LOCAL ISSUE WHICH WOULD BE BEST SOLVED THROUGH STATE BY STATE ATTENTION, AND IT NECESSARILY FOLLOWS THAT S.744 SHOULD PROGRESS NO FURTHER.

THANK YOU FOR THIS OPPORTUNITY TO ADDRESS THIS COMMITTEE. I WOULD BE PLEASED TO ATTEMPT TO ANSWER ANY QUESTION YOU MIGHT HAVE.

The CHAIRMAN. Thank you, Mr. Brandt.

Senator Gorton, do you have anything you wish to say?

REMARKS OF SENATOR GORTON

Senator GORTON. Thank you, Mr. Chairman. I appreciate your calling a hearing on an issue which is both controversial and vitally important and your giving an opportunity for the presentation of so many views, some agreeing and some conflicting.

I appreciate the presence of many witnesses here. I do want to echo something which you said earlier. I don't believe that we can separate the plight of the farmers and the other agricultural interests and the plight of the financial institutions which have provided them with support and with capital over so long a period of time. I hope that the net result of this hearing will be that these contending parties will meet together to see whether or not they can't resolve their difficulties and come to us, if not with that absolutely ideal something to which everyone agrees, some proposal which meets with broad approval throughout the two elements in our society which are mutually interdependent and can't be treated with separately.

The CHAIRMAN. Thank you, Senator.

Mr. Gunderson.

STATEMENT OF DAN A. GUNDERSON, EXECUTIVE DIRECTOR, MINNESOTA AGRI-GROWTH COUNCIL, INC.

Mr. GUNDERSON. Thank you, Mr. Chairman. I appreciate the opportunity to be here today. I am the executive director of the Minnesota Agri-Growth Council. The Agri-Growth Council is the umbrella organization representing Minnesota's agricultural and agribusiness industry. Our members include farmers, commodity associations, large and small agri-businesses, livestock and grain buyers, cooperatives, independent bankers, and agricultural lenders such as the Farm Credit System.

LOSSES IN MINNESOTA

I'm afraid that I must disagree with my distinguished panelist that there's no double-jeopardy problem. Over the past few years hundreds of individual losses have been suffered by Minnesota's grain and livestock buyers as a result of claims made by secured creditors. I personally know of claims or losses ranging from a few hundred dollars up to three-quarters of a million dollars in Minnesota alone.

Because of these losses, the Agri-Growth Council stepped forward in Minnesota to be a catalyst for legislation that is now law in our State. We initiated meetings among members of the Agri-Growth Council, between lenders and buyers, to try to reach a compromise on this difficult issue.

After many meetings and after addressing alternatives such as central filing, affidavits, the Illinois law, and a complete repeal of the exception, we came to the conclusion that there were two proposals. The buyers wished to have outright repeal and the bankers wished to have central filing or congressional action.

We drafted legislation that is listed in my testimony or restated in my testimony. I won't read that, but I might point out that in summary it basically operates that a buyer in the ordinary course of business who purchases farm products from a person engaged in farming operation takes free of a perfected security interest created by the seller unless: One, the buyer is notified by the secured party of the security interest, or two, that the buyer is not registered as a buyer in the seller's county of residence.

The first part of that you'll notice is almost identical to S. 744 and the second part basically was an approach that we took that asked the agricultural products buyer to define his purchasing area by county in order to receive protection under this law.

Lenders, knowing where their farmers reside, can then find out the buyers to notify by contacting the appropriate county recorders to acquire the list.

Mr. Chairman, Senator Gorton, this law has been in effect since September 1, 1985, and even though that is a very short time, we've had considerable feedback from buyers, lenders, and farmers. Buyers have indicated general support for the law. They are being notified by lenders and they are making out joint checks. Farmers have had a mixed reaction. While they do not like checks made out in joint, they realize that their marketing alternatives were becoming increasingly limited if buyers continued to suffer double-jeopardy losses. This was especially evident in a recent case where a small southwestern Minnesota cooperative elevator had a $90,000 claim on a purchase from one farmer on a single year's crop. In that case, every farmer member of that cooperative will lose.

Lenders, surprisingly, have gained a new appreciation for this law because they are now almost assured of payment. They either have a joint check or a case against the buyer.

On September 18, 1985, in a hearing before the Minnesota Legislature, both the Farm Credit System and the Minnesota Bankers Association testified that the double-jeopardy law appeared to be working and that it should be given a reasonable time to fulfill its objective.

Let me emphasize that last spring both of these organizations spent considerable time and effort in attempting to stop this legislation.

SUPPORT FOR S. 744

I am here today, Mr. Chairman, because I would like to emphasize that while we're attempting to work with our law, had S. 744 been passed in 1984, I don't believe that the Minnesota Legislature would have acted in 1985. We believe that on the national level S. 744 adequately and uniformly addresses the issue within the UCC in a fashion very similar to Minnesota. It is our hope that you will pass this legislation.

I might also point out, Mr. Chairman, in testimony and in comments made that the ASCS officer in our State indicated in carrying out his Federal responsibilities that they had $14 million in documented double-jeopardy claims. There's also been speculation that this type of legislation, S. 744 and what we're experiencing in Minnesota, would assist the Federal Government in policing some of the movement of grain, particularly within storage, under Federal law.

We believe it's working. We would prefer, however, to see S. 744 for uniformity within the Uniform Commercial Code.

[The complete prepared statement follows:]

TESTIMONY OF
DAN A. GUNDERSON, EXECUTIVE DIRECTOR
MINNESOTA AGRI-GROWTH COUNCIL, INC.
BEFORE THE U.S. SENATE COMMITTEE
ON BANKING, HOUSING & URBAN AFFAIRS
HELD IN WASHINGTON, D.C.
ON WEDNESDAY, OCTOBER 9, 1985

Mr. Chairman, members of the Senate Banking, Housing & Urban Affairs Committee, my name is Dan Gunderson and I am Executive Director of the Minnesota Agri-Growth Council. The Agri-Growth Council is the "umbrella" organization representing Minnesota's agriculture and agribusiness industry. Our members include farmers, commodity associations, large and small agribusinesses, livestock and grain buyers, cooperatives, independent bankers and agricultural lenders. I appreciate the opportunity to be here today to discuss the so-called "clear title" issue.

Over the past few years hundreds of individual losses have been suffered by Minnesota's grain and livestock buyers, as a result of claims made by secured creditors. I personally know of claims, or losses ranging from a few hundred dollars up to three quarters of a million dollars.

Let me give you a specific example of the type of situation that arises for buyers. During the last five years a small livestock buyer in Harmony, Minnesota, purchased feeder pigs from a farmer. During that time he made out 19 separate checks for payment to that farmer, seventeen of which were actually deposited in the farmer's account at the bank holding the security interest in the livestock. In the past year, the secured party, the bank, has made a claim under the ag products exception against the buyer from Harmony for payment on all of the livestock sold over the entire five year period, for which the buyer has already made payment. The buyer clearly faces a dilemma which we, in Minnesota, like to refer to as "double jeopardy".

Because of losses such as this and many others, the Agri-Growth Council stepped forward as the catalyst for legislation that is now law in Minnesota. This "double jeopardy" law is very similar in concept to S.744 currently before this committee.

Minnesota law states:

> Sec. 6. (223A.01) (FARM PRODUCTS THAT ARE BOUGHT SUBJECT TO A SECURITY INTEREST.)
>
> Subdivision 1. (REGISTERED BUYER TAKES FREE OF SECURITY INTEREST UNLESS NOTIFIED.) A buyer in the ordinary course of business who is a registered buyer in the county of the seller's residence under section 386.42, and who purchases farm products from a person engaged in farming operations takes free of a security interest created by the seller even though the security interest is perfected and the buyer knows of its existence, unless the buyer is notified of the security interest as provided in subdivision 4.
>
> Subd. 2. (BUYERS THAT PURCHASE SUBJECT TO A SECURITY INTEREST.) A buyer in the ordinary course of business that is registered under

section 386.42 in the seller's county of residence who is notified by a secured party as provided under subdivision 3, purchases farm products from a person engaged in farming operations subject to the perfected security interest. A buyer who is not registered under section 386.42 in the seller's county of residence purchases farm products from a person engaged in farming operations subject to perfected security interests.

A buyer who purchases farm products subject to a security interest under this section shall include the name of the secured party as joint payee on any check or other instrument issued in payment for the farm products, unless the secured party gives the buyer written notice of waiver of this requirement. Issuance of joint payment as herein required relieves the buyer of any further liability to the secured party.

Subd. 3. (NOTIFICATION OF SECURITY INTEREST.) A secured party may, by certified mail or another method by which receipt can be verified, notify a buyer that a debtor has farm products subject to a security interest.

The notification is effective upon receipt until September 1 after the notification is made; or for a notification made after August 20 but before September 1, the notification is effective for one year beginning September 1. A buyer who receives notification from a secured party under this subdivision shall not publicly post or disseminate to any person, other than its agents and employees who reasonably require the information for purposes related to this act, any information contained in the notification.

A secured party that furnishes to a buyer a list of debtors who have farm products subject to a security interest is not liable to a debtor whose name is on the list for furnishing the list.

Sec. 7. Minnesota Statutes 1984, section 336.9-307, is amended to read:

336.9-307 (PROTECTION OF BUYERS OF GOODS.)

(1) A buyer in ordinary course of business (subsection (9) of section 336.1-201) takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence, except that a buyer in the ordinary course of business who purchases farm products from a person engaged in farming operations is subject to section 386.42.

The mechanics of implementing this law are based upon two concepts. First, that an ag products buyer shall define his purchasing area by county. In other words, to receive protection under this law, buyers must be registered as such, in the county recorder's office of the counties where their farmers reside. (This year buyers are registering in an average of 4.5 counties out of the 87 in Minnesota.) The second concept is that a lender, knowing where his farmers reside, can find out the buyers to notify by contacting the appropriate county recorders to acquire the list. Buyers must define their purchasing area and lenders must know where their farmers reside.

This law has been in effect since September 1, 1985; and, even though that is a very short time, we have had considerable feedback from buyers, lenders and farmers. Buyers have indicated general support for this law. They are being notified by lenders and they are making out "joint" checks. Farmers have had a mixed reaction. While they do not like checks made out in joint, farmers realize that their marketing alternatives will become increasingly limited if buyers continue to suffer double jeopardy losses. This was especially evident in a recent case where a small southwestern Minnesota cooperative elevator had a $90,000 claim on a purchase from one farmer on a single year's crop. In that case every farmer-member will lose. Lenders, surprisingly, have gained a new appreciation for this law because now they are almost assured of payment. They either have a joint check or a case against the buyer.

In fact, on September 18, 1985, in a hearing before the Minnesota Legislature, the Farm Credit Services and the Minnesota Bankers Association testified that the "double jeopardy" law appeared to be working and that it should be given reasonable time to fulfill its objective. Let me emphasize that last Spring both of these organizations spent considerable time and effort in attempting to derail this legislation.

We believe that on the national level, S.744 adequately addresses the issue in a fashion similar to Minnesota. It is our hope that you will pass this legislation.

Dan A. Gunderson, Executive Director
Minnesota Agri-Growth Council, Inc.
8030 Cedar Avenue South, Suite 213
Bloomington, Minnesota 55420

Phone: 612/854-1665

The CHAIRMAN. Isn't it true that S. 744 would eliminate some of the Minnesota law?

Mr. GUNDERSON. Mr. Chairman, as I understand it, yes, it would. But there's such similarity between the two laws that we don't foresee any difficulty.

The CHAIRMAN. I would interpret your testimony as very good testimony for States rights. Illinois apparently has done a good job. Minnesota, according to your testimony, has done a good job. And the point there, rather than just a blind defense of States rights, in both cases you have been able to tailor make it to your particular needs in your States.

Why can't other States do the same thing?

Mr. GUNDERSON. Mr. Chairman, I don't know why other States can't do it. I do know that we worked on this issue for 3 years and acted over the objections of the various lending associations right up until final passage of the legislation.

So I'm not certain whether other States can act individually in every case. However, I do believe that grain movement and livestock movement is not limited to the boundaries of the State of Minnesota and the intent of the Uniform Commercial Code to bring uniformity and in the interest of a national law that works for everyone and we support S. 744.

FEDERAL PREEMPTION BASED ON INTERSTATE MOVEMENT

The CHAIRMAN. But that has always been the excuse for Federal preemption for everything, that things cross State boundaries. That's standard. I don't criticize you for using it. Everybody does, and we have certainly opened up a lot of Federal intervention and centralization of Government in Washington on that basis, if something crosses a State line.

Mr. Brandt, you represent the Nebraska Bankers Association, not the national association. I was very tough with Mrs. Smith and John White from the Farm Bureau and the Cattlemen's Association on getting together. I would go back and I assume they're not still here, but to Mr. Lemon who represented the American Bankers Association and Bud Gerhart the Independent Bankers Association—if anybody is here listening for them—I would put the same pressure on them to initiate a phone call and not wait for the other. They should try to get together in a sincere effort, because there has not been much incentive for the farmer side of it to go ahead because they knew they could get what they wanted out of the Agriculture Committee. There hasn't been a lot of incentives for the bankers to go along because they would prefer no change at all. They're satisfied with what is there. So I would like the pressure to be equal on both sides of this argument. As I say, they have probably left. If not, you hear my words. Why doesn't everybody initiate a call and see if you can talk about this? You know, the worst possible thing that could happen is that you fail and you can't achieve a compromise and we're back where we started. But at least you can try.

I feel very strongly about that, that you ought to try and do that on both sides. And I really believe you will benefit if you are willing to give a little bit on each side to come up with a compromise rather than putting Congress in the position of taking these absolute positions one way or another.

I do very much appreciate all of you witnesses being here to express your opinions. I apologize for the lack of the attendance of the committee. It is not lack of interest in the issue, but we cannot anticipate when we schedule hearings that we're going to have Prime Ministers of Singapore or heads of state show up to give speeches in joint sessions of Congress.

Mr. BRANDT. Mr. Chairman, my remarks were abbreviated and I would request that my full prepared testimony be submitted for the record.

The CHAIRMAN. It certainly will be and, again, we would request those who have testified to pick up the questions this afternoon for your responses in writing.

Mr. GUNDERSON. Mr. Chairman, if I could ask that my remarks be put in the record also. And we would be glad to work in any way we can to bring about a compromise.

The CHAIRMAN. Everybody's testimony will be put in the record in full. Thank you very much.

The committee is adjourned.

[Whereupon, at 11:35 a.m., the hearing was adjourned.]

[Response to written questions and additional material for the record follow:]

STATE BANK
DEPARTMENT

Tower Bldg. - Suit
323 Center S
Little Rock, Arkansas 72201

Bill Clinton

Marlin D. Ja
Commissi

Honorable Marlin D. Jackson's reponse to questions relative to Senate Bill 744.

1. If S. 744 were passed into law, would many agricultural bankers loans be treated as unsecured loans? What effect would this have on bank safety and soundness?

ANSWER

It is widely recognized that approximately one-third of the present farmers of little debt could obtain credit under the most adverse circumstances.

Unfortunately, the more highly leveraged two-thirds (or at least 50 percent) of the farmers would have a great deal of difficulty in obtaining credit as the major portion of their loans would be treated as "unsecured loans".

The reason major portions of the loans of the highly leveraged farmers would be treated as "unsecured loans" lies in the fact that the farmers are highly leveraged, they have little equity in their land and frequently they have little, if any, equity in their equipment. Thus, the bank, the Farmers Home Administration or the Farm Credit System Bank that makes the production loan has to rely heavily upon the agricultural livestock or commodities. If Senate Bill 744 is passed into law so that at some point in time in the marketing process the lien-rights of the creditor is limited or stopped, it would relegate the loan to an unsecured basis.

The affect that this would have on a bank's safety and soundness is obvious. Banks that continue to extend credit to farmers, wherein a major portion of their security lies in liens on their crops and livestock, would constitute unsafe and unsound banking practices.

2. Mr. Jackson, your testimony discusses the infrequency of farmer conversions, in your experience. Would you say, however, from your experience in examining community banks in Arkansas, that the incidence of conversion is increasing as the farm problem deepens?

ANSWER

Yes. Unfortunately, there is an old Arkansas saying, "desperate men under desperate circumstances can and do become desperadoes". In other words, the more stress the farmers experience, the more frequent inappropriate conversions will occur.

Senate Bill 744 does nothing to alleviate the incident of conversion. It simply changes the risk and the loss, when improper conversion occurs from the grain merchant or meat packer to the community banks, PCAs, Farmers Home Administration and Commodity Credit Corporation.

3. S. 744 contains a provision that continues the priority of the security interest of the lender over the purchaser, if the lender gives actual notice to the purchaser of the lien within twelve months immediately preceding the sale of the collateral. Would it be possible for agricultural banks to give such notice, in your experience? Would this vary from crop to crop - depending on the geographic market and the number of buyers?

ANSWER

It would be possible to give some notice to some of the potential purchasers. However, it is very impractical.

There is a vast difference between "possible" and "practical!".

The ability to give advance notice varies greatly from crop to crop, depending on the geographic market and the number of buyers.

In my home community of Paragould, Arkansas, situated in the extreme northeast corner of Arkansas, it would be virtually impossible to accurately identify the potential buyers, because of the geographic location of the farmers in the Paragould trade territory. Customers of the bank with which I was associated for some 15 years marketed their crops in the southeast one-third of Missouri, a small portion in the southwest corner of Kentucky, a significant amount of the crop was marketed in west Tennessee, i.e., Memphis, some crop was marketed in north Mississippi and obviously, vast portions of the crop and livestock were marketed throughout the State of Arkansas.

Advance notice is a very impractical approach to the solution for this problem. It is not a solution that is well received by potential purchasers of either grain or livestock. The fact is, advance notice will predictably result in prospective purchasers being "drowned" in a sea of paperwork.

4. Would you favor a registration system for lenders and buyers to relieve the possibility of double payments by buyers, despite the problems discussed in your testimony?

ANSWER

If for reasons unknown to me, a change has to be made to the present system, which has served uniquely well, a registration system or central filing system appears to be the most viable and practical solution for the producers, buyers and those who finance both the production and purchases.

5. You discussed the chaos that has resulted from the changes in the law in Iowa. Do you have any information on the effects in California

or Tennessee, states which have flatly eliminated the farm products exception?

ANSWER

No.

6. It has been argued that central filing does not work, is this true?

ANSWER

Central filing works only when the prospective purchasers are concerned enough about the possibility of "double payment" (double jeopardy) to run a lien search to determine the existence of liens. Sometimes, prospective purchasers do this by paying a modest fee to the clerk for a list of all lienholders. Sometimes they do this simply by asking the farmer to sign a statement as to whether or not a lien exists.

The fact is, few purchasers can, under oath and under the penalty of perjury, testify that they have lost money after having conducted lien searches under the present filing system.

Given the fact that the purchasers of grain and livestock do not wish to be bothered with checking, even at the local court house, it is highly unlikely that they would have any greater inclination to check with the central filing system, such as the Secretary of State or some other designated official.

7. Mr. Jackson, in your testimony, you state:

"There is no doubt that the enactment of S. 744 will have a very negative affect and will seriously reduce the availability of credit for farmers and ranchers."

Now no doubt it will have an effect, but could you verbalize on your allegation of "seriously"?

ANSWER

The 25 - 40% of the most highly leveraged, heavy debt-laden farmers and ranchers will experience significant difficulty in obtaining credit, because the repayment of a major portion of any credit they obtain is predicted upon a good and valid lien on the crops and livestock they produce.

No one can predict with any degree of accuracy, even with the use of quadratic equations, vatarian decisions or lenial programming of computers, a close estimate of the number of farmers who will be seriously and adversely effected.

Logic clearly indicates that perhaps as many as 50% of the farmers in the extremely economic distressed sector of the agriculture society (approximately one-third of the farmers and ranchers) will be unable to obtain credit, if Senate Bill 744 is enacted in its present form.

Perhaps a better approach would be to look at the total picture of famers and ranchers, who have obtained credit for annual production purposes.

When comparing those who will be unable to obtain credit, if Senate Bill 744 is enacted, it is my firm conviction that between 15 and 20% of the farmers and ranchers in the mid-south, who otherwise could obtain credit, will be unable to do so because of the increased risk in obtaining credit.

IN CONCLUSION

It is imperative that the members of Congress recognize that the international robber grain barons and the mammoth poultry and meat processors are not concerned and are not attempting to eliminate the normal risk of their business transactions involved in the purchase of agriculture products and livestock. Rather, they are attempting in the midst of chaos that exists, because of the farm credit crisis, to shift the risk that is normal to their business and industry to the capital accounts of community banks, PCAs, Farmers Home Administration (i.e., the taxpayers) and the Commodity Credit Corporation.

Much has been said about the "exemption"; however, farm commodities are treated no different than real estate or automobiles. When a merchant buys real estate or an automobile, he does so under the most ancient of English common laws - caveat emptor (let the buyer beware).

It is my understanding that all Federal banking regulators, including the examiners for the Office of the Comptroller of the Currency, as well as the examiners for the Federal Deposit Insurance Corporation, are significantly increasing loan classifications in those states where lien-rights have been modified or abridged.

I implore you to obtain testimony from the Director of Bank Supervision of the Office of the Comptroller of the Currency and testimony from Robert Shumway, Director of Bank Supervision of the Federal Deposit Insurance Corporation as to their experience in states where lien-rights have been abridged or modified; as well as their testimony on the probable impact the enactment of Senate Bill 744 will have on the treatment afforded by these two national banking regulators, which impact the total 14,000 commercial banks in this country.

Thank you for permitting me to express my views on this subject.

NATIONAL CATTLEMEN'S ASSOCIATION
5420 South Quebec Street • P.O. Box 3469 • Englewood, Colorado 80155 • (303) 694-0305

NCA

OFFICE OF THE PRESIDENT

October 11, 1985

Ms. Virginia Anne Housum,
Counsel
Committee on Banking
SD-534
Washington, DC 20510

Dear Ms. Housum:

Central filing is not the same as central notice. Senator Andrew's proposal is a central notice system which has been passed in North Dakota but is not in effect and has no track record. If S.744 becomes law in its present form, any state could continue to utilize a central filing system but could not use a central notice system to pre-notify buyers. Lenders would continue to file financing statements to establish a priority against other lienholders and against buyers not in the ordinary course of business.
The NCA has several concerns and reasons for opposing a central notice system like Senator Andrews is proposing.

1. Senator Andrew's proposal allows constructive notice which in many cases will mean actual notice from the bank will never occur.

2. This proposed central filing system will certainly create a blizzard of paperwork to any and all potential buyers.

3. Allowing a state to use a different system than surrounding states disrupts the uniformity that S.744 seeks to establish. Furthermore, how would North Dakota deal with out of state buyers and/or sellers? (Many who may be one-time buyers or purchase every few years, would be caught in a difficult situation. Ullike grain for instance, livestock must be moved quickly.)

4. Probably most importanly, with a central notice system, it would be very easy for banks to send in mortgage on all loans. Therefore, if you assume 95% of all ag sales are mortgaged products, then this system assures that two party checks will be issued on almost all sales. I do not believe we should promote or encourage this activity; neither lenders, producers, or buyers want this to occur.

The NCA recognizes the importance of state's rights and weighed this against the need for uniformity in the U.C.C. when selling and buying farm products. Allowing Senator Andrews' proposal to be added to S.744 as an amendment would just be the first step in promoting non-uniformity, plus it presents many philosophical problems.

Sincerely,

Jo Ann Smith

Jo Ann Smith
President

Questions for the Record Relating to S.744

Senator Alan Dixon

S.744 provides protection for commission merchants and selling agents. Section 307 of the UCC, however, only protects buyers in the ordinary course of business. What is the rationale for also protecting agents? Are there unique circumstances in agriculture that require more protection than provided in other industries covered by the UCC?

A. 1. Commission merchants that buy livestock are considered buyers of livestock under the U.C.C. and therefore are subject to "double payment" like other buyers. The Packers and Stockyards prompt pay provisions present an additional problem to these folks. Selling agents are again "sellers" under U.C.C. definitions.

The uniqueness question in agriculture is an often cited reason for making different rules for agriculture. The nature of our industry has changed considerably over the years. The sophistication level of producers has increased over the years and we no longer have uneducated non-businessmen producers. In fact, the economic conditions have weeded any weak producers and todays producers are indeed business minded cattlemen.

If the agricultural exception is eliminated, is it appropriate to clarify the applicability of the Bulk Sales Act to sales of agricultural products?

A. 2. Because of changes in marketing techniques such as forward contracting, futures trading, direct selling, etc. we have moved to a pattern of marketing products all year. Cattlemen realize in order to avoid missing market lows, they need to market cattle to different sources and over time to maximize profit or more importantly loses.

MS. HOUSUM'S QUESTIONS

Q. 1. Your testimony discussed the difference between purchasing a load of gravel, and purchasing a load of corn. Do you think part of the problem is that the corn loses its identity immediately upon your purchase, either by being commingled with other corn, or by being turned into additional weight on your steers?

A. 1. You are correct in stating that corn loses it's specific identity when sold and commingled with other corn or feed to livestock. However, gravel also loses its identity when sold and placed in a driveway or used in concrete. Please keep in mind that a creditor's rights to proceeds from the sale of corn do continue after the sale.

Q. 2. Have you experienced double liability for any agricultural products you purchase?

A. 2. Fortunately, I have not been involved in a double jeopardy case personally. However, I represent the National Cattlemen's Association as President, therefore, I am representing the sentiments and concerns of all member cattlemen. Several of our members have lost a great deal of money when forced to pay for cattle or feed twice. In a couple of circumstances these people are no longer members because they were forced into bankruptcy and out of the cattle business. I would like to note that it is not the frequency of "double payment" cases that presents the real problem but rather the "magnitude" of loss when they do occur. In addition, this glitch in the UCC forms a dark cloud over all agricultural transactions.

Q. 3. When you drive into town to purchase a load of corn, do you know when you leave your ranch who you intend to buy the corn from?

A. 3. Yes, much the same as I know where I will purchase other non-ag products. The real issue is the feasibility of ascertaining who file where, and under what name. Furthermore, the time spent checking is a cost of doing business that is not reinbursed in any fashion and even worse does not guarantee that I, as a buyer, will not have to pay twice.

Question for Mr. Gunderson:

Senator Cochran's original bill did not provide for prenotification, but merely eliminated the farm products exception. What was the position of the agricultural industry in Minnesota that caused it to agree to the notification procedure, rather than a flat elimination of the exception?

MR. GUNDERSON'S RESPONSE:

While my Congressional District is adjacent to Minnesota, I do not know if the "agricultural industry" of that state has agreed to the prenotification procedure as opposed to an outright elimination of the exception.

Speaking for Wisconsin farmers and agricultural interests, however, I can say that--undoubtedly--they would prefer a simple elimination of the farm products exception. It certainly would be the most equitable solution since the law would, then, treat buyers of all goods in the ordinary course of business in the same manner. That's why I cosponsored legislation in the 98th Congress that would have simply eliminated the exception--nothing more, nothing less.

However, given the length of time the exception has existed, the dependence of some lenders on the exception, and--most importantly--in the spirit of compromise, we have accepted the prenotification procedure on the House side. It truly is a "half way" solution for it maintains liability for buyers of ag products under certain limited (and more equitable) circumstances, namely when the buyer has written notice of the lien and has instructions as to what to do with the proceeds from the sale of the commodity involved.

Steve Gunderson

FEDERAL DEPOSIT INSURANCE CORPORATION, [illegible]

[illegible]

October 11, 1985

Honorable Jake Garn
Chairman
Committee on Banking, Housing and
 Urban Affairs
United States Senate
534 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Mr. Chairman:

This is in response to your letter of October 10, 1985 to Graham Northup regarding S. 744. This proposed legislation would preempt the Uniform Commercial Code and any other applicable state and local laws by requiring lenders to notify potential farm product buyers of liens against those products in advance of a sale in order to protect the lender's security interest in the collateral. The present UCC rule provides that a buyer takes possession of farm products subject to any outstanding perfected liens. A buyer must check to see if there are liens against products he plans to buy. The purpose of the change is to preclude buyers from having to pay twice for the same agricultural goods when such goods serve as collateral for a loan the selling farmer subsequently fails to repay.

Your October 10 letter asked two specific questions. In response to the first, loans held by agricultural banks might very well be classified as unsecured loans if S. 744 is enacted. A bank that is a secured lender would continue to have an interest in collateral, but the bank's priority could be lost if it did not follow rather strict procedures to notify potential purchasers of the collateral of the existence of the bank's lien. It is not possible to know all possible purchasers in every instance. Consequently, there would always be the potential for the bank to lose its priority on the lien, and it could be faced with an unsecured loan.

In evaluating such a loan, the examiner would have to consider, in addition to the usual credit factors, the bank's lending procedures and its adherence to these procedures. If the bank's procedures were deemed adequate and were being followed, the examiner would in all probability view the loan as secured. If the procedures were not viewed as adequate or were not being followed, the credit would probably be viewed as unsecured. The enactment of S. 744 would in any event place a tremendous burden on the bank to develop procedures to insure beyond reasonable doubt the validity of its lien position. There would be no way to be absolutely certain that any given set of procedures would be adequate for all situations.

Your second question requested our opinion about the overall effect of S. 744 on the commercial agricultural banking industry. We believe it could dry up credit for farm production loans. When legislation is enacted that has the effect of casting doubt on a bank's ability to collect its loan through the sale of underlying collateral, there will be an extreme reluctance to lend on that type of collateral. Lenders will be less likely to make loans if the security of their collateral is undermined.

We are also concerned about the adverse effect S. 744 would have on the FDIC's liquidation activities. Workout arrangements with financially strapped farmers would be made more difficult because there would be no certainty that the collateral pledged in the workout arrangement would be available later, such as at the end of a growing season when the collateral is a crop in the field.

Shifting the burden of guaranteeing the security of farm products as collateral from the buyer to the lender really accomplishes little. Unpaid loans would remain unpaid no matter who must ascertain the collateral's continued presence. Farmers in trouble will remain in trouble, but will have fewer sources of needed future financing to provide continued opportunities for pulling through these financially difficult times.

Thank you for soliciting our views on this important matter.

Sincerely yours,

Margaret L. Egginton

Margaret L. Egginton
Deputy to the Chairman

American Farm Bureau Federation

WASHINGTON OFFICE
600 MARYLAND AVE. S.W.
SUITE 800
WASHINGTON, D.C. 20024
AREA CODE 202 - 484-2222

October 11, 1985

Senator Jake Garn
Chairman
United States Senate Committee
on Banking, Housing and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Garn:

I appreciate the opportunity to respond in written form to your questions concerning my testimony to the Committee on Banking, Housing and Urban Affairs on October 9, 1985. I would like to take the opportunity to clarify the American Farm Bureau's history of meeting and discussing this issue with representatives of the lending industry.

The American Farm Bureau has been working on the issue of clear title for several years. In 1983 and 1984, American Farm Bureau hosted eight to ten meetings in our offices at which the lenders' groups were represented. Additional such meetings were held in 1985 including several meetings with the American Bankers Association and Farm Credit Council prior to House adoption of H.R. 1591. In addition, in states where the clear title has been the subject of state legislation, numerous meetings of state Farm Bureau staff and leaders have taken place with representatives of the banking and lending industry. We continue to avail ourselves to the lending industry in order to seek resolution to this problem. I would like to point out, however, that the American Farm Bureau became involved in this issue in order to remove the farm products exception from the UCC. We have, in the spirit of compromise, considered many alternative proposals which offer the lending interest some protection in the event that the UCC exception is removed. In our judgment, the actual notice system provides the best source of that protection. However in our meetings, the banking industry has not accepted the concept of removing the farm products exception from the UCC. It is in this basic area of difference where compromise has become extremely difficult.

Listed below are the questions which have been submitted to me and my written response:

Question: Do you think S. 744 might be more efficacious and impose less risk on the farm credit system if a provision for a $5,000 penalty on farmers were eliminated and replaced with criminal sanctions on farmers who sell to buyers and convert the proceeds of the sale?

Answer: S. 744 does not interfere with state laws regarding farmers who convert the proceeds of the sale. The penalty imposed in S. 744 relates to the failure to comply with requirements to notify the banker when a sale is completed to a party not originally included on a list of potential buyers. Inclusion of criminal penalties are unnecessary in that current state laws regarding conversion of the proceeds from a sale would still apply in these cases.

Question: S. 744 provides protection for commission merchants and selling agents. Section 307 of the UCC, however, only protects buyers in the ordinary course of business. What is the rationale for also protecting agents? Are there unique circumstances in agriculture that require more protection than provided in other industries covered by the UCC?

Answer: The protection in S. 744 applies to commission merchants and selling agents only in that they are operating as an extension of the seller or buyer. Any knowledge which such commission merchant or selling agent has of a lien is imprecise and unofficial. Selling agents will not have received notification with the exception of those cases in which the agent is operating on the behalf of the buyer. Therefore, the protection extended to the selling agent is only that which has been afforded to the buyer or seller under the Uniform Commercial Code. It is not a special circumstance of agriculture which necessitates such protection.

Question: If the agriculture exception is eliminated, is it appropriate to clarify the applicability of the Bulk Sales Act to sales of agricultural products?

Answer: The legal concept of "bulk sale" is a term of art that goes beyond mere large sales, which makes it quite different than the situation addressed by the farm products exception

Removal of the farm products exception will affect only buyers and sellers of such goods "in the ordinary course of business." Despite the seasonal nature of such sales, it is clear that routine sales of crops of livestock raised in the course of a producer's operations is in "the normal course of business." Lenders are aware of the seasonal cycle of agriculture and expect such sales of all or part of a crop during a particular time of year. For sales of agricultural products not in the ordinary course of business (such as a sale of a dairy herd upon a farmer's retirement), any security interest would follow the products sold.

A bulk transfer, on the other hand, is defined in UCC 6-102(1) as a transfer in bulk "not in the ordinary course of a transferor's business." It is an unexpected sale of a major part of inventory. Because lenders do not expect such sales, creditor notifiaction is much more necessary and equitable in this situation than in sales of agricultural products.

It is the intent of the "bulk transfer" provisions to protect creditors from extraordinary transfers or sales, not those occurring as a result of ordinary business.

For these reasons, no amendment or clarification of the "bulk transfer" law is necessry if the farm products exception is removed.

Question: What are your views of the North Dakota central notice law and its applicability to S. 744?

Answer: The American Farm Bureau has some very serious concerns regarding the North Dakota central notice law, as does the North Dakota Farm Bureau. Use of central notice has some serious implications for farmers and lenders in that such a system relies on constructive rather than actual notice. The result of such a system is expanded bureaucratic involvement in the notification system which not only involves an expanded role of government in this process but also involves problems with liability for accuracy in reporting the existence of a lien.

In an actual notice situation such as would occur under S. 744 as currently written, responsibility for notification lies with the lender and responsibility for accurately filing the notice lies with the buyer with no third party intervention in between. Any inaccuracy that might occur would clearly be the responsibility of one of those two parties. Under a centralized system, an inaccuracy may occur as the result of actions of a state employee who would have no liability.

The second area of concern is that buyers must register for such a notification system. In many cases, farmers purchase agricultural products on an infrequent basis such as one per year. However, they would need to apply and pay for access to a list which would be mailed from the centralized state office on a monthly basis. Therefore, a buyer who is in the market infrequently would incur greater cost per sale and would receive notification of all liens in the state, which would be an unnecessary paper burden.

The distribution of such a list would be a record of total indebtedness of farmers in the state which Farm Bureau objects to. This list could be used against farmers in loan application proceedings and violates the farmer's right to privacy in his financial matters. Under actual notice, only those buyers with whom the farmer would expect to do business would be notified.

The final concern concerning this proposal is that it will be inapplicable in cases where sales are made across state lines. A buyer not regularly conducting business in the state of North Dakota may not have regular access to the list of existing liens.

I thank you for the opportunity to testify and present the views of the American Farm Bureau to the Senate Banking Committee. I hope that the response to your questions is useful to you in consideration of S. 744.

Sincerely,

John White, Jr.
President
Illinois Farm Bureau

October 10, 1985

Ms. Virginia Anne Housum
Counsel
Committee on Banking, Housing,
and Urban Affairs

Dear Ms. Housum:

I have been asked to respond to questions addressed to me and am pleased to do so. It is my understanding that the answers will be made part of the hearing record of S.744.

Q. Do you require health certificates on animals you auction?

A. Usually health certificates are not requird in Pennsylvania. One exception is at special sales of replacement dairy cattle. On a nationwide basis, certificates are usually needed to accompany feeder cattle when shipped across state lines. The health certificates are written by state or federal officials and almost always after the sales transactions.

Q. When does your company actually make contact with producers whose animals you auction?

A. At various times during the year. Very often, my customers will visit the market on an off-sale day for the purpose of discussing market prices, feed conditions, etc. Very seldom do I have contact with the producer on the day his livestock are marketed. In our area, hired truckers usually deliver the livestock from farm to market where we sell them by auction and most often, pay by mailing the check. It should be noted that every week I have consignments from producers whom I've never met.

Q. Do you deal with the same producers season to season or year to year?

A. Generally, yes. Although there are a few producers in the Carlisle Livestock Markets "trade area" who use my market only sparingly and some who sell at Carlisle as well as other markets, many producers in my area sell most of their livestock production through the Carlisle Market. However, without notice provisions (as in S.744) relating to liens, each marketing transaction is a new one as mortgages can be lifted, or new liens attached to the livestock at any time of the year.

Q. Do you have inspectors who examine animals and/or their living conditions before you agree to auction them?

A. State and federal animal health officials are present at the market on sale days. Their primary concern is the handling practices of the markets. In Pennsylvania, we are fortunate that we have very little livestock disease. Seperately, officials do make spot checks of Pennsylvania farms to determine if livestock are properly cared for. These inspections are not connected to the sale of the livestock at auction markets.

Q. "In short, I am curious why you cannot do cursory UCC searches before the auction."

A. I have attached a copy of my written statement which is to be made part of the hearing record. On the first page of that statement, I have underlined paragraph four which addresses your curiosity. I call your attention to that paragraph and repeat:

> It is not practical, and, in fact, is often impossible to determine the existance of liens by search, and, at the same time, comply with payment regulations. Dozens, sometimes hundreds, of consignors from several counties and, often, from more than one state coupled with not only a business need to pay promptly for this livestock, but a law that mandates markets to make payment before the end of the day following the sale, does not allow markets to obtain the lien information which is needed to protect themselves.

Q. Mr. DeGaetano, your written testimony refers to your efforts to have state law amended, why are you here now instead of continuing in your efforts to proceed to modify state laws?

A. Again, I call your attention to my written testimony--75 copies of which were made available to the Committee staff--a copy of which as noted, is attached. Paragraphs three and four of the second page have been underlined on the attachment and I direct your attention to them. The livestock marketing industry believes that a federal solution to the "double jeopardy" problem is needed because of the large percentage of livestock that is moved and marketed on an interstate basis. Additionally, attornies have warned us that state law changes may very well not cover transactions involving the federal lender, the Farmers Home Administration. Federal legislation would include FMHA without question.

You have asked that I comment on Senator Andrews proposal which would amend S.744 to allow notice to buyers and markets by a system developed by individual states and referred to as a "central notificatin system".

Obviously, the North Dakota law which Senator Andrews describes is a step in the right direction. The North Dakota legislature has recognized the need to improve a bad situation. I have not had as much time as I would like to study the proposal and I would like Livestock Marketing Association's attornies to look at it. But, I am aware that time is important in the progress of S.744, so I offer the following observations.

Although notice of livestock markets by a central system could very well be workable,, I'm not totally in agreement with the provisions which create costs for buyers although I readily admit that those costs (in North Dakota) are not excessive. However, the cost of obtaining the information and the equipment (reader) may be prohibitive for individuals (farmers and feeders) who occasionally buy farm products from producers.

North Dakota law does not, because it cannot, address those transactions involving North Dakota products sold in other states or livestock and grain produced in neighboring states and sold in North Dakota. Therefore, the provisions of S.744 regarding notice by lender or borrower will still be a necessary part of many transactions.

It seems to me that notice by a central source would be especially beneficial to lenders and if they (lenders) would absorb the costs of such system and, also, be responsible that potential buyers be notified through that system, that the purpose of S.744 would remain the same. North Dakota law does not do that.

Your letter solicits comments "concerning the possibility of formulating filing procedures specifically applicable to borrower/farmers who have not established long term banking relationships". Frankly, I am not sure what that means; but, passage of S.744 as now before the Banking Committee treats new security agreements between lenders and farmer/borrowers the same as those borrowers who have lengthy banking relationships. The lenders or borrowers simply notify the buyer/market of the existence of a lien and the buyer/market responds by issuing a check made payable to those who have an interest in the farm product. Everyone benefits under S.744.

Sincerely,

Jim DeGaetano

Jim DeGaetano

THE FARM CREDIT COUNCIL
1800 MASSACHUSETTS AVE, NW · WASHINGTON, DC 20036 · 202/466-4180

Delmar K. Banner
President

October 11, 1985

The Honorable Jake Garn
Chairman
Senate Committee on Banking,
Housing and Urban Affairs
U.S. Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Please find attached our responses to the additional questions submitted by the Committee with regard to your recently held hearings on S. 744.

In addition, we would like to take this opportunity to respond to your request for our views regarding Senator Mark Andrews' proposal which was outlined during testimony before your Committee during that same hearing.

While we have not had a chance to review Senator Andrews' proposal in detail, nor within any official policy context, we would like to make several observations.

To begin, we strongly agree with Senator Andrews that any legislative proposal not only address the concerns of buyers of agricultural products, but also recognize the need to protect the legitimate interests of lenders.

In an effort to address these twin concerns, Senator Andrews has proposed an amendment which, as we understand, would allow individual states to enact legislation establishing a "central notification system" and to the extent it provided "constructive notice," such a system would meet the requirements for pre-notification under S. 744.

While we believe such a proposal to have considerable merit, we are concerned that while it may work well in one state, such as North Dakota, it may not in another state simply because the nature and size of its agricultural economy may be substantially different.

For this reason, we continue to be supportive of a compromise proposal outlined in our testimony which was developed in conjunction with the National Council of Farmer Cooperatives. At the same time, we want to commend Senator Andrews for his efforts to develop an acceptable compromise which would address the concerns of all parties.

Again, we want to express our appreciation to you and the Committee for your interest and look forward to continuing to work closely with you and your staff on this important issue.

Yours very truly,

Delmar K. Banner

Attachments

QUESTIONS FOR MR. SWACKHAMMER:

1. Please state for the record who the constituents of the Farm Credit Council are.

Response: Late in 1982, through the efforts of leaders from the nation's Farm Credit banks, a district farm credit council was chartered in each of the nation's 12 Farm Credit districts. Each of those district councils is a regional trade association of cooperative farm lenders with membership drawn from the borrower-owned Farm Credit banks (i.e. the federal land bank, federal intermediate credit bank, bank for cooperatives) and associations (i.e. federal land bank associations and production credit associations) and other cooperative lenders within its region. Together, with the Central Bank for Cooperatives in Denver, these 12 district councils comprise the membership of the federated Farm Credit Council.

2. Let me ask you the same question I asked Mrs. Lawrence. Why is there such a diversity of opinion between USDA and the Farm Credit council on this issue?

Response: Secretary Block has spoken for the Department of Agriculture on this issue, and in so doing it is assumed he represents the position of the Administration. The private, borrower-owned Farm Credit lending institutions whose membership the Farm Credit Council represents are connected in no way to the Department of Agriculture. They are regulated and supervised by the Farm Credit Administration, an independent federal agency.

3. What has been the experience of the membership of the Farm Credit Council in attempting to collect from purchasers of agricultural products after a farmer defaults?

Response: Overall, the experience of local associations in collecting from purchasers has been mixed. Very often an association will hesitate to collect from a local cooperative because of shared membership and resulting negative publicity. However, such an action often proves necessary, especially in cases of larger sales. Usually associations are able to recoup their loss through the court system, although many times out of court settlements are negotiated.

As you are probably aware, it has proven to be more difficult for associations to prosecute or recoup the loss from the producer, in large part due to the unwillingness of county and/or federal attorneys to prosecute.

4. From your perspective, which laws are superior - the Farm Credit Exception under the UCC, written notice to buyers, or central filing?

Response: While the UCC Exception does provide the most protection to lenders, the Council is not arguing simply to retain the status quo. We believe, however, that the problem under current law is not that lenders have too much protection given the unique risks associated with the financing of farm products; rather, the problem is that buyers lack an easy and practical means of determining whether a security interest exists in the products they purchase.

As we see it, the solution lies not in reducing the protections which farm lenders currently enjoy, but in devising a means by which buyers can more readily and efficiently determine whether the commodities they purchase are encumbered. The approach we prefer as an alternative to S. 744 combines the options of written notice to the buyer with a certificate obtained by the buyer at the point of sale. It also involves stiffer criminal penalties for those who would divert sales proceeds. This particular combination of elements has not been tried before. In our view, it is the approach best designed to permit an equitable sharing of responsibility among all the interested parties--buyer, producer and seller--to deter diversions and see that the loan obligation is met.

Both written notice by itself and central notification would also be significant improvements over the current system from the standpoint of the buyer, although lenders will obtain a greater security through centralized notification and both lenders and buyers could eventually find centralized notification more efficient and less costly. At the present time the chief problem with central filing is the lack of uniformity among the states. About eighteen states have adopted some form of central notification.

IBAA
INDEPENDENT BANKERS
ASSOCIATION OF AMERICA

B. F. Backlund
President

Charles T. Doyle
President Elect

Thomas H. Olson
Vice President

Charles L. VanArsdale
Treasurer

October 11, 1985

Hon. Jake Garn
Chairman
Committee on Banking, Housing and
  Urban Affairs
534 Senate Dirksen Office Bldg.
Washington, D.C. 20510

Dear Senator Garn:

The following are my responses to the questions submitted to us, for the record of the hearings October 9 on S. 744.

Questions for the Record Relating to S.744

The Farm Credit Council has provided the Committee with an approach to the Agriculture Exception-UCC issue. Under the Farm Credit Council's proposal, buyers would get clear title if they requested and received from the seller written certification indicating the absence of liens on the commodity, or if they were notified of the existence of a lien and paid for the commodity with a two-party check. How would you compare this proposal with S.744? Does it go at least part way towards resolving the problems lender groups have with S.744?

As you know, Illinois eliminated the agricultural exception and substituted a new procedure designed to protect good-faith purchasers while also protecting legitimate lender interests. Do you believe the Illinois statute provides an adequate degree of protection for both the lender's and the buyer's legitimate concerns? Do you believe the Illinois statute, or at least elements of that statute, can be a model for federal legislation in this area?

Please comment on the viability of the Farm Credit Council's proposal for a compromise on the issue of priority between secured lenders and purchasers of agricultural products.

ANSWERS

IBAA is in general agreement with the approach in the "North Dakota Central Notice Law", as proposed by Senator Andrews. If the approach in the North Dakota law were to be incorporated into a national statute, at least two considerations are very important: (1) it should be made clear that the provisions regarding lien checks, joint payments, etc. apply to marketers as well as buyers of farm products; and (2) a state which does not currently provide for a central notice system should have a sufficient period of time (three years would be appropriate) to put into place such a central notice system prior to any preemption of the state's existing procedures. With those considerations, we believe that the North Dakota approach would be acceptable and workable approach.

The Farm Credit Council's proposal is less acceptable than the proposal by Senator Andrews. Under the central notice system, the buyer receives notice regarding the lien status of farm products offered for sale directly from secured lien files, not indirectly through the seller/debtor. In these times of severe financial stress, normally honest people can be moved to do dishonest things, and seller/debtors under extreme stress may convey fraudulent information to the buyer or marketer. Although penalties can be applied in such instances, it is clearly preferable to have an efficient way to verify liens in advance of sale and payment, rather than pursuing misconduct in the courts after farm products are converted improperly.

The Illinois statute, as I understand it, is basically a combination of provision for individual notice similar to S. 744 and penalties against sellers for the unauthorized sale of mortgaged farm products. I think that this statute would be basically consistent with S. 744 with respect to the relationship between lenders and buyers and therefore in effect would not be preempted by S. 744, since penalties in state law related to sellers would not be disturbed. As a model for federal legislation, we believe that the North Dakota central notice system is preferable.

Regarding the possibility of formulating filing procedures specifically applicable to borrower/farmers who have not established long-term banking relationship, I don't think that it should be necessary to do. The basic filing procedures, if maintained in effective status, should adequately cover this segment of borrowers. We have not had an opportunity to study this aspect thoroughly, however.

I hope that these responses are helpful to the Committee.

Sincerely,

Bud Gerhart
Chairman
Agricultural-Rural
Committee

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON D.C. 20250

Honorable Virginia Anne Housum, Counsel
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Ms. Housum:

Enclosed with this letter are answers to five questions attached to your memorandum of October 9, 1985, which I submit for the record of my testimony in your hearing on the bill S. 744.

Your memorandum also asked for comments on the North Dakota Central Notice Law as explained by Senator Andrews. Under that plan, the Secretary of State publishes monthly a list of mortgage and lien holders, which is distributed to farm product buyers in the State. Buyers then have an opportunity to write joint checks in payment for products from sellers on the list. If the lender chooses not to participate and a seller's name is not on the list, the buyer takes free and clear. The Secretary of State's office acts as a clearinghouse so that a single list covers all filings for the State, eliminating the need for lenders to provide their own lists to buyers and requiring buyers to maintain multiple lists.

From a standpoint of administrative efficiency, the North Dakota approach appears to have merit. It also encourages voluntary participation by the lender and buyers, and strengthens a responsible concept of federalism.

In addition, as to the possibility of establishing special filing procedures for borrowers without established banking relationships, we have no specific recommendations at this time.

Sincerely,

Kathleen W. Lawrence

KATHLEEN LAWRENCE
Deputy Under Secretary for
Small Community and Rural Development

Enclosure

ANSWERS TO QUESTIONS SUBMITTED TO KATHLEEN LAWRENCE, DEPUTY UNDER SECRETARY OF AGRICULTURE FOR SMALL COMMUNITY AND RURAL DEVELOPMENT, FOR THE SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

(Hearing of October 9, 1985, on the bill S. 744)

Questions:

1. I am sure that you are aware that your testimony is considerably at variance with that of Mr. Swackhamer. Since he represents lending institutions that are part of the Farm Credit System, which USDA regulates, could you please explain the basis on which USDA has concluded that S. 744 imposes no risk on the Farm Credit System lenders?

Answer: The Department of Agriculture does not regulate the Farm Credit System and, therefore, is unable to provide the information requested.

2. How much of the $150 billion debt held by the Farm Credit System is secured by crop liens? Does the Farm Credit System presently have information on buyers of commodities produced by its borrowers from which those institutions could give notice to the buyers of their liens?

Answer: Again, this question should be directed to the Farm Credit System.

3. What is the total amount (in Dollars) of USDA's Farm Product Loans? What do you expect to extend on current product loans?

Answer: The Department does not have a farm-product loan category. The Farmers Home Administration currently has almost $6 billion in operating loans outstanding. Most of those loans are secured by chattels, which include crops, livestock, machinery and equipment. The exact amount secured by chattels (and which type) versus real estate is not available since the nature of the security for each loan is recorded only in the individual loan docket.

Fiscal 1986 operating loans authorized by PL 99-103 (continuing resolution) total $390 million through November 14, 1985.

The Commodity Credit Corporation has crop loans currently totaling approximately $11.9 billion.

4. Are these funded by taxpayers dollars?

Answer: The FmHA loans are funded by the proceeds of sales of Certificates of Beneficial Ownership to the Federal Financing Bank. The Bank buys those securities with funds raised by selling Treasury securities on the financial markets.

CCC loans are funded by direct appropriations of the Congress.

5. Are you willing to relinquish your current lien position to buyers of farm products on $160 million of loans?

Answer: We are not willing to relinquish our lien position on any of our loans and believe that the pre-notification provisions of S. 744 will adequately protect the Government's interest.

GLEN E. LEMON, Chairman of the Board,
First Bank and Trust, Booker, Texas;
Vice Chairman, Government Relations Council,
American Bankers Association

Responses to the questions from the Senate Committee
on Banking, Housing, and Urban Affairs

Question

1. Your testimony appears to object to any requirement that a lender provide notice to a purchaser of farm products. Wouldn't it be relatively simple to ask a farm borrower to state who his buyer will be, since it's probably his local grain cooperative in most cases? A continuing warranty that he will inform you of any changes in his intended purchaser would also give a lender the ability to terminate the credit, at least, if the farmer did not provide this information.

Response

1. The American Bankers Association (ABA) does not object in principal, to the requirement that a lender provide notice to a purchaser of farm products. However, we are very concerned about the mechanism through which such a requirement would be implemented. The real issue is how a lender can adequately provide notice to the buyer and how a buyer can adequately receive that notice so that the burden does not fall uniquely on one party.

S. 744 both shifts the entire burden of notice to the lender and fails to provide an adequate mechanism for giving notice. A lender has no way of knowing when and to whom a farmer may choose to sell his farm products. Although in some parts of the country a farmer may frequently sell his products to a local grain cooperative, in many other areas, there is no such defined practice. Because this legislation is national in scope, it must respond to the variety of farm products transactions.

In many areas, it would be impossible for the lender to even know about, much less give written notice, to all potential buyers and the cost would be prohibitive. On the other hand, it is clear that a lender cannot realistically rely on the cooperation of the borrower in this instance, particularly where the borrower's only incentive to cooperate is the possible imposition of a fine which is inconsequential when compared with a sale of farm goods running into hundreds of thousands of dollars. Any legislation in this area must therefore either provide a practical method for the lender to transmit information to the buyer and/or a strong incentive to discourage fraud and encourage cooperation on the part of the farmer-borrower.

Question

2. What was the reason for the farm credit exception? Is it still necessary today?

Response

2. During the last century, there were severe legal obstacles to the use of farm products as collateral for securing a loan. For example, no mortgage could be extended on goods not yet in existence. Thus an unharvested crop would not provide a valid security interest. Furthermore, identification of the collateral had to be specific. In livestock financing, this meant that any additions to the herd required the execution of a new mortgage. Perhaps the most significant obstacle was the

rule that that authority to sell the collateral invalidated a lender's security interest, _see_ _Benedict v. Ratner_, 268 U.S. 353 (1925). This last rule prohibited inventory mortgages as well as farm products mortgages.

These rules were changed over time in the majority of jurisdictions so that both farm products and inventory could provide adequate security for a loan. Many statutes (in particular, Factors Lien Acts and the Uniform Trust Receipts Act) arose which expressly permitted inventory financing. However, none of these statutes was willing to extend the lender's security interest in inventory to a buyer in the ordinary course of business. The law thus encouraged the marketability of goods and protected the rights of retail buyers who were free to assume that they had a clear title to the goods they purchase.

The statutes applying to inventory financing did not apply to farm products collateral--(for a discussion of pre-Code inventory and farm products financing, see 2 _Gilmore_, _Security Interest in Personal Property_, sec. 26 (1965)). Therefore, farm products purchasers did not take free of a security interest held by the seller. The farm products rule developed as a corollary to inventory financing by virtue of its exclusion from the laws governing inventory financing.

Although the pre-Code law exempted farm products purchasers from the buyers in the ordinary course of business exception, it also exempted bulk buyers, _see_ Uniform Trust Receipts Act sec. 1 (excluding transfers in bulk from the definition of buyer in the ordinary course of business). This granted extra security to lenders accepting inventory goods as collateral.

The UCC codified these various legal rules in a system of secured financing. The historical division between farm products and inventory resulted in separate legal rules, which, taken as a whole, form a more or less balanced system. Removal of the farm products exception from the UCC might narrow the distinction between farm products and inventory, but changing only one provision would skew the present balance in the UCC. Farm products creditors would receive less protection from fraud on the part of borrowers than inventory creditors who can at least rely on UCC Article 6, see Response to Question 4below, for further discussion of bulk sales law. Any change in current law needs to take into account the function and the role of the UCC as an integrated statute.

Question

3. Do you know the experience of lenders in Tennessee and California, since those states repealed the farm products exception? It is argued that central filing does not work in states where it has been tried, any comment?

Response

3. The ABA has little information regarding the experience of lenders in Tennessee. Tennessee did not remove the farm products exception from its version of the UCC until 1983. We also understand that the Farm Credit System, rather than commercial banks, is the major agricultural lender in

Tennessee. In addition, it must be remembered that Tennessee's deletion is limited. Lenders may still enforce farm product liens against licensed selling entities (e.g. auction barns, grain warehouses, etc.) where the lender has given such entities actual written notice prior to sale.

The ABA has more information on the situation in California. The law removing the farm products exception from the California Code was enacted in 1974. While we know that banks have continued to extend agriculture credit in California, there are several points to note. As reported by the Federal Reserve Bank of Chicago in the November/December 1985 issue of Economic Perspectives, California banks have the highest ratio of farm loans charged off as a percentage of all farm loans in a bank's portfolio. The rate in California was twice as high as the next highest state and almost three times higher than the national average.

In addition, regardless of how much agriculture lending occurs in California, the agricultural system as it exists in California is not an appropriate model to hold up as an example of how a deletion of the farm products exception would work in the rest of the country. Unlike other agricultural states, there are a limited number of buyers for the major crops produced in California. Many California farmers are members of cooperatives which have marketing agreements which require all farm products to be sold to the co-op. In addition, many lenders will not extend credit unless the farmer/borrower has a buyer committed to buy the crop at harvest. Finally, lenders often obtain a written assignment of the crop proceeds from the seller authorizing the buyer to make direct payment to the lender.

In response to the Committee's question regarding central filing, the farm product buyers often complain that the information contained in the register is hard to obtain, inaccurate, outdated, or difficult to use because the seller of farm products may be operating under a different name than the one appearing in the lien registry. The short answer to these complaints is that they are over-exaggerated and are the same types of difficulties faced by lenders when attempting to gain a priority lien position by filing and perfecting their security interests. In all fairness to the buyers, it is clear that some states, Nebraska for example, have recognized that their filing systems can be improved. However, when groups such as the National Grain and Feed Association claim that Nebraska has rejected centralized filing as being unworkable, then they are being inaccurate. Nebraska law currently states that a central notice system providing for 24-hour access shall be in place by 1988.

While there may be difficulties with the centralized filing concept, these are essentially technical in nature and can be remedied at the state level. Federal preemption of such systems without allowing for state innovation is unjustified.

Question

4. Mr. Lemon, your testimony cleverly compares the farm products exception to a mortgage. This is a good analogy, because farm products arer really fixtures to the underlying land before they are harvested. But once they are harvested, isn't it a better analogy to goods, which under Section 9-307 a buyer without actual knowledge always takes free of lien? If not, why not? Is there a better analogy to bulk sales under Article 6 of the UCC? Since a farmer does not replace his "inventory" after harvest, it seems that he has made a sale like a bulk sale, which Article 6 would require him to advertise and provide actual notice to his lien creditors.

Response

4. Farm products comprise a unique type of collateral the characteristics of which cannot be wholly analogized to either a real estate mortgage or to an inventory mortgage. While farm products do bear some resemblance to inventory goods, they are dissimilar from them in very important respects.

First, the nature of the two buyers is different. The farm products buyer is generally more sophisticated than the average purchaser at retail for whose benefit the UCC buyer in the ordinary course of business exception developed. Second, agricultural products are both fungible and perishable and cannot be easily traced. It is difficult for a lender to physically inspect and keep track of the collateral. Finally, and most importantly, the two types of sales are different. Whereas the inventory dealer sells his products in small quantities and replenishes his stock as it is depleted, the farmer is likely sell much of a crop or a herd at one time. This type of "bulk" sale makes defrauding a creditor easier and more tempting.

The bulk sale of inventory goods may trigger the application of UCC Article 6. Article 6 of the Code is designed to protect both the secured and unsecured creditor against a fraudulent transfer of the inventory by the debtor to whom credit is extended, see UCC 6-101 Official Comments (1977).

Article 6 requires compliance with special notice formalities in connection with "bulk transfers"--transfers usually by a retail merchant of some substantial part (normally over 50%) of his inventory other than in the ordinary course of business. The UCC requires the seller to prepare a list of his creditors and requires the buyer to send written notice of the sale to each creditor listed or otherwise known by the buyer, UCC 6-104, 6-105, and 6-107(3) (some states have adopted simpler notice provisions, such as recording of the notice of a proposed transfer and newspaper publication of it). If the bulk seller fails to comply with the statute, the transfer to the buyer, even if he purchases in good faith, is ineffective, UCC 6-105. The creditors may seize the goods by judicial process in satisfaction of their debts as if the transfer had never been made. However, if the bulk buyer transfers the goods to a subsequent good faith purchaser for value before the bulk seller's creditors discover the scheme, then the innocent second buyer receives clear title.

Article 6 does not, in any case, apply to farm products, UCC 6-102(3) Official Comment 2 (1977). Furthermore, Article 6 requires that the bulk sale be out of the ordinary course of business. Farm products, however, are sold in bulk in the ordinary course of trade. Thus, if a farm products lender could not rely on the farm products exception of UCC 9-307(1), it is clear that he would actually receive less protection from fraud on the part of a borrower than an inventory lender who can at least rely on Article 6 for protection.

Question

5. Please comment on the viability of the Farm Credit Council's proposal for a compromise on the issue of priority between secured lenders and purchasers of agricultural products. (This is also the response to the first question posed by Senator Alan Dixon.)

Response

5. The major difference between the Farm Credit Council's (FCC) proposal and S. 744 is the manner in which notice of liens is given to the buyer. S. 744 provides that in order to enforce a security interest lenders or sellers must send to the farm product purchaser written notice of the security interest (and any payment obligation imposed on the buyer) within one year prior to the sale. As we understand it, the FCC proposal would, among other things, require the buyer to supply a "lien disclosure certificate" to the seller stating

whether a lien exists or not. The certificate is effective for one year and criminal penalties are imposed for failure to disclose liens. While the provision of a certificate is an improvement over S. 744 (since it reduces the problem lenders face in identifying potentil buyers), a serious flaw remains. Because the certificate indicating the presence or absence of liens is signed by the seller, the possibility of fraud still remains. The reason the problem of double payment exists in the first place is the fraud committed by a few unscrupulous sellers of farm products. It appears that the only way to ensure the accuracy of the disclosures is to remove the opportunity for committing fraud. There are several practical methods for accomplishing this objective including central filing of farm product liens or creating a central registry for buyers of farm products. The registry of buyers would give lenders a means of identifying potential buyers without having to involve the seller in the process.

Question (From Senator Alan Dixon)

As you know, Illinois eliminated the agricultural exception and substituted a new procedure designed to protect good-faith purchasers while also protecting legitimate lender interests. Do you believe the Illinois statute provides an adequate degree of protection for both the lender's and the buyer's legitimate concerns? Do you believe the Illinois statute, or at least elements of that statute, can be a model for federal legislation in this area?

Response

The ABA believes that, for the most part, Illinois' statute on the farm products exception is so similar to S. 744 that it provides no greater degree of protection for either lenders or buyers. Most of the arguments we raised against S. 744 are equally applicable to the present version of Sec. 9-307 found in the Illinois Code.

In essence, both S. 744 and Illinois law provide that a buyer takes free of a security interest in farm products unless the buyer has received (or under Illinois law has been "given") prior written notice of the lien. Under S. 744 the notice can come from either the secured party or the seller while Illinois law states that the secured party is to give notice to the buyer by registered or certified mail. S. 744 provides that written notice must be received by the buyer within twelve months prior to the sale while Illinois law establishes a five-year period for notification prior to sale. The information to be provided to buyers is similar under both approaches except that S. 744 contains the additional requirement that the buyer be notified of "any payment obligation imposed on the buyer . . . as a condition for the waiver or release of the security interest . . . ." S. 744 totally exempts commission merchants and selling agents from the farm products exception while the Illinois law (like the House Bill) includes them under the same prenotification rules as buyers. Unlike Illinois law, S. 744 contains a method for sellers to provide lenders with a list of potential buyers.

While S. 744 contains civil penalties for "off-list" sales, it lacks the criminal penalties contained in Illinois law for the sale of farm products subject to a security interest.

Because S. 744 and present Illinois law are so similar, the ABA does not believe the statute can serve as a model for federal legislation, although the addition of criminal penalties to S. 744 would be beneficial. The major problem with S. 744 and Illinois law is the method used to prenotify the buyer. Neither approach provides a satisfactory method of giving notice. While buyer groups complain that the present system of public notice through filing is unworkable, the methods of sending notice to buyers suggested, in S. 744 and Illinois law do not appear to be an improvement. How are lenders going to identify potential purchasers? (Does it make sense for the lender who wishes to protect its security interest to rely on a list provided by the same person who will be committing the fraud?) We envision a blizzard of paperwork being sent to all possible buyers in an effort by lenders to protect themselves. Even then there is no assurance that the lender is adequately protected since the possibility will always exist that the buyer has not received written notice.

AGRICULTURAL BANKING INSTITUTE

Walter W. Minger
President

William K. Dabaghi
Arter & Hadden
General Counsel

Mailing Address:
P.O. Box 65320
Washington, D.C. 20035-5320

FOR IMMEDIATE RELEASE October 9, 1985

PRESS RELEASE

On October 9, 1985, Marlin D. Jackson, Bank Commissioner of Arkansas, testified before the Senate Committee on Banking, Housing and Urban Affairs on behalf of the Agricultural Banking Institute.

Commissioner Jackson stated his firm opposition to S.744, a bill which would federally override the "Farm Products Exception" contained in section 9-307 (1) of the Uniform Commercial Code (UCC) and replace it with a nationwide prenotification system. This provision requires lenders to notify potential buyers of farm products of liens against those products in advance of a sale in order to protect the lenders' security interests in their collateral. Commissioner Jackson strongly stated that "at a time when it is most difficult for farmers and ranchers to obtain funds, it is inappropriate to restrain state lender rights or increase the risks for lenders to make these loans."

It is important to remember that the regulation of commercial transactions has traditionally been the province of the states. One of the primary purposes in the states enacting the Uniform Commercial Code is to assure that the states retain control of regulating the basic commercial law of the country while fostering uniformity. "There is no sound reason for the federal government to remove state lender rights related to farm and ranch products."

In the midst of the farm credit crisis, farmers and ranchers are having greater difficulty in obtaining funds. It is, therefore, not the time to do anything that would inhibit agricultural producers from obtaining funds. Retention of this state law is most important in today's agricultural economy where availability of credit is becoming essential for the continued survival of many farms and ranches. Today's crisis is one of agricultural lenders as well, with the largest number of agricultural banks in recent memory having substantial portfolios of non-performing loans. The Commissioner stated that, "this is a classic example of various powerful interest groups motivating the federal government to restrict the rights of states in ways they otherwise would not be able to do."

For further information, contact Fred Rose at (202) 857-0960.

Offices: 1919 Pennsylvania Avenue N.W., Suite 400, Washington, D.C. (202) 857-0960

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

October 15, 1985

The Honorable Jake Garn
Chairman
Committee on Banking, Housing,
  and Urban Affairs
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

Thank you for your letter of October 10, 1985 asking that we comment on two issues which arose during hearings held on S. 744, the Farm Products Purchasers Protection Act.

You ask whether S. 744 if enacted into law would result in loans held by agricultural banks being considered unsecured loans. From a supervisory standpoint, the enactment of S. 744 in itself would not affect security positions involving dairy cattle, livestock and staples secured by warehouse receipts. However, the perfection of liens is the determining factor. Loans will continue to be considered secured if liens are properly recorded with the county and state authorities, if lien searches are on file which document first lien positions, and if notification to potential buyers is made before sale.

You also ask what overall effect S. 744 would have on the commercial agriculture banking industry. We believe that modification of the Uniform Commercial Code, as called for in S. 744, is an issue for the states to resolve. The uniform commercial code governing commercial transactions was adopted in various forms by the states and is subject to modification by them. It is our understanding that, to date, fourteen states have responded to the concerns of purchasers of agricultural products and passed legislation to modify or delete the farm products exception without material adverse effects on credit availability or bank losses. It is our understanding that other states are currently reviewing the exception.

In our view, S. 744 would place significant new burdens on agricultural lenders. By requiring that banks notify potential purchasers as to outstanding liens and provide security releases as obligations are paid off, it would shift responsibility away from purchasers, who currently have to research liens before buying commodities, to financial institutions. This could result in less aggressive and more costly lending to farmers. In addition, the bill could increase banks' risk of loss since lenders would no longer have full recourse to purchasers where commodities were sold without satisfying bank liens.

S. 744 would also create additional risks of loss for banks by failing to assure that adequate notice will be given to purchasers when products are sold through a commission merchant or selling agent. The bill completely relieves such commission merchants and selling agents from any responsibility to protect the lender's security interest by providing that they shall not be liable to lenders who have a security interest in farm products sold by them even if they are aware of the security interest.

I hope these comments are helpful to the Committee in its consideration of this issue. Please do not hesitate to contact me if we can provide clarification or supplemental information.

Sincerely,

Joe Selby

H. Joe Selby
Acting Comptroller of the Currency

TESTIMONY

FROM THE KANSAS BANKERS ASSOCIATION

ON S. 744

Presented to THE SENATE COMMITTEE
ON BANKING, HOUSING AND URBAN AFFAIRS

Presented by:

RICHARD D. NICHOLS, President
Home State Bank & Trust Co.
McPherson, KS

and President-elect,
Kansas Bankers Association

TESTIMONY ON S. 744

Mr. Chairman and Members of the Committee:

The Members of the Kanas Bankers Association appreciate very much the opportunity to present testimony on S. 744 relating to that section of the Uniform Commercial Code which contains the provision popularly known as the "farm products exception."

Kansas is a state which relies as heavily as almost any state in the Union on its agricultural production as a means of maintaining a healthy state economy and that production relies, in turn, on a good working relationship between agricultural producers and agricultural lenders. In 1984 Kansas banks ranked first in the United States in terms of the percentage of total farm credit held by banks within a state. Direct agricultural loans held by Kansas banks total slightly under $3 billion as of year-end 1984. That totals 18% of total bank deposits in our state.

A recent article in the ABA Bankers News Weekly listed the top 10% of agricultural banks in total dollar volume of agricultural loans in the Plains Region (North Dakota, South Dakota, Nebraska, Kansas, Oklahoma and Texas). Included in that list were 33 Kansas banks. It should also be noted that 415 of 626 Kansas banks (66%) qualify as agricultural banks by having 25% or more of their loan portfolio in agricultural loans. Thus it is obvious that any change in laws relating to the advancement of credit to agricultural borrowers is going to have an enormous impact on the lending practices of most Kansas banks. The elimination of the "farm products" exception to the UCC would have a serious effect on the nature of agricultural lending and that would, in turn, adversely affect the entire Kansas economy which is directly dependent on agriculture.

The Kansas Bankers Association is strongly opposed to the provisions of S. 744 and respectfully urges the Committee to report it adversely. The Kansas Uniform Commercial Code is an important factor in permitting private lenders to provide farm production loans at reasonable costs. Production of farm products is financed with loans for which those same products serve as both primary security and the principal source of repayment. The Uniform Commercial Code in Kansas provides banks and other farm lenders whose loans are secured by farm products with the legal ability to enforce their security interest. It should be noted that this concept in agricultural lending pre-dates the adoption of the UCC in Kansas and has been part of our state commercial lending laws since statehood. We would urge the Commmittee to insist upon receiving evidence that a large practical problem now exists, before changing an important commercial practice of over 100 years duration. We have seen no such evidence.

The "farm products exception" of the UCC favors the availability of credit to agricultural production by recognizing the market reality that the proceeds for most collateralized production loans are generally applied to retire the secured loan, and thus the "farm products exception" is the primary legal means available to most agricultural lenders to satisfy the repayment of farm production loans. Having extended credit to the producer on the strength of the self-liquidating lien, removal of the "farm products exception" would strip lenders of an important means by which to police their collateral as well as the principal source of repayment.

It is very important to remember that the overwhelming percentage of farm product sales are not between farmers, but are between the farmer and sophisticated commercial purchasers who should be well aware of their responsibilities. These sales are, for all practical purposes, "bulk" sales of grain and livestock and are very much like "bulk inventory" sales. Interestingly, Article 6 of the Uniform Commercial Code requires the purchase of bulk inventory to notify creditors prior to purchase. The Uniform Code commissioners understood this similarity when they created the Code and is a key reason why they provided for the "farm products exception."

We fully understand that the Uniform Commercial Code is a very complex document and Article 9 of the Code is designed to insure a maximum flow of credit. Over the past 20 years each state has adjusted the Code to fit its agricultural environment. This is one of the main reasons why we in Kansas strongly oppose the passage of a national law which nullify these individual state adjustments of "fine tuning". We have made several minor adjustments to the UCC in Kansas and in 1983 we made a major change in the filing of financing statements on loans involving farm products. Our state legislature passed that year Senate Bill 7 which created a central filing system with the Secretary of State for all financing statements involving farm products.

We worked closely with such groups as the Kansas Livestock Association and the Kansas Grain and Feed Dealers who also requested passage of the bill because we fully understand that searching for existing liens entails some effort on the part of the buyer. Our central filing act became effective on January 1, 1984,and by all indications is proceeding smoothly. By 1989 all filings which had been made locally with the Registers of Deeds relating to farm products will be transferred to the Secretary of State's office and it will be possible to gain information relating to any filings simply by calling the Secretary's office. The law, in fact, provides that the Secretary must, by January 1, 1986, provide telephone service for inquiries on any filings in his office. The Secretary of State is currently providing computer printout lists to subscribers and has computerized its Uniform Commercial Code operation in order to more rapidly process all requests.

The Kansas Bankers Association in an attempt to cooperate with various farm groups, established the KBA Lien Search Service in January of 1984. This service allows banks, grain elevators, livestock auctions and any other buyers of farm products to call the KBA office with request for lien searches and we then provide same day service by checking on these requests with the Secretary of State and calling the requesting party back the same day. It should be noted that the most frequent users of our service have been the grain companies throughout the state of Kansas. Since January of 1984 we have processed over 5,000 name requests from nearly 50 different grain companies throughout the state. Surely this is evidence that the present system is workable, and with minimum effort, secures buyer safety.

We strongly believe that once the Kansas central filing system is fully implemented it will be one of the most sophisticated systems in the United States and will provide purchasers of farm products with easy access to any filings there may be relating to those farm products. State officials and the Kansas legislature have made a major monetary commitment to see this central filing system work and we strongly believe that it is proving its ability to handle information rapidly and thus give the buyers of farm products easy access to needed information.

One of the major complaints raised by those who would like to see the "farm products exception" eliminated is the so-called problem of "double jeopardy". This is the notion that a buyer is forced to pay twice because the farmer failed to apply the proceeds from the sale of the product to satisfy the lien on those products. However, it must be emphasized that the "problem" of double payment is certainly avoidable under the present provisions of Article 9 of the Code simply by checking with the appropriate agencies for liens recorded by the lenders. Purchasers of farm products are now and always have been in a position to protect themselves from the possibility of double payment. As noted above the process of checking has now been made much simpler in Kansas by the formation of a central filing system. We are concerned that Congress is now considering legislation that would render worthless all the time and money spent to make our system workable.

Proponents of the provisions of S. 744 often promote the argument that they should not be responsible for the policing of agricultural loans, but as shown in the comments of Kansas bankers in the addendum to this testimony it is virtually impossible for a small town banker to track the dozens and sometimes hundreds of agricultural loans which he has on his books. Given the modern day ability to move grain and livestock over long distances in a short period of time the banker is virtually helpless to track on a weekly or monthly basis the status of his collateral. The median deposit size of Kansas banks is $17 million and quite obviously the number of employees in these banks is very limited so passage of a "clear title" provision would adversely impact the small ag banks more dramatically than any other.

The idea that purchasers of farm products are placed in a somewhat unique position of having to check for existing liens prior to purchase of farm products is simply not true when the process for acquiring real estate or motor vehicles is considered. Certainly no one would consider acquiring a home or a car without first checking to see if there were any existing liens. It should also be noted that banks obviously must check for any existing liens prior to the time that a commitment on agricultural credit is made and for the potential purchaser of farm products to check for existing liens is only a logical part of the process. The fact is the buyer is the only person who is in an absolute position to know when the sale of farm products is occurring and therefore is the logical and exclusive party to be in a timely and responsible position to check on existing liens at the time of the sale of the products.

Most importantly the removal of the "farm products exception" would have the effect of substantially reducing the willingness of creditors to make certain agricultural loans. As numerous Kansas bankers have noted in their comments on this legislation, in order to maintain the same level of protection againstdefault which is provided by the Code's "exception", lenders would be forced to seek additional collateral for their loans or to lend only to those farmers who could qualify for unsecured loans. In any case, the cost of credit will most likely increase while overall farm credit will be reduced.

Members of this committee are well aware that we are now experiencing in Kansas and other Midwest states a very difficult time in our agricultural economy and any changes in the law which affect the long standing procedures by which agricultural loans are extended is only going to create further deterioration in the agricultural economic picture. While this bill might grant purchasers of farm products a reprieve from their responsibility for lien searches it would, in turn, punish a great many more agricultural borrowers throughout Kansas and other states. To dry up the credit supply for farmers and ranchers in an attempt to stop the acts of a few unscrupulous agricultural borrowers who do not repay their loans seems to us to be an unreasonable price for the agricultural producer to pay. What has been to this point a very minor problem in agricultural lending could turn into a major problem in agricultural lending with the elimination of the "farm products exception".

Kansas bankers are working very hard today in spite of economic and regulatory pressures to keep many Kansas farmers in business. Whether this will be possible depends not only on the economy, but also on the attitudes of our regulatory and legislative bodies. No doubt many arguments can be made for creating changes in the Uniform Commercial Code, but we believe the key point which you as a Committee must consider is whether such a change in the UCC will, in fact, be in the best interest of the farmer and the rancher and in the best interests of the entire agricultural economy of this country.

Once again, Mr. Chairman and Members of the Committee, we thank you for the opportunity to present to this committee our viewpoints on this extremely important issue relating to Kansas and its agricultural economy. We respectfully urge you to oppose this legislation because of its adverse impact on the availability and cost of agricultural credit.

COMMENTS OF
KANSAS BANKERS ON REPEAL
OF THE "FARM PRODUCTS EXCEPTION"
IN THE UNIFORM COMMERCIAL CODE

....How in the world does a lending institution check for a lien that they already have on farm products that are being sold to a third party, when the lender knows nothing about the sale? Only the buyers are in a position to make sure that neither they nor the lender are jeopardized by the financially distressed farmer who may suddenly have lost his integrity.

The interests of agricultural lenders and agricultural borrowers are the same on this issue. If clear title becomes law, then the terms set by lenders will be more onerous, because if they can't protect themselves one way, they will do it another. In fact, the thinly capitalized farmer will probably find that obtaining credit against these items will be very difficult, if not impossible.

Noel D. Rooney, President
Peoples State Bank, Minneola, KS.
(53% of all loans are for agricultural purposes)

The new filing system which your association so vigorously supported is less than one year old. We believe that this system will provide quick and accurate information regarding potential liens on livestock and grain to potential purchasers. The availability of credit for agriculture will be also significantly impacted if lenders can not assure themselves that their lien does not remain in effect once loan collateral is sold.

Marion S. McMillan, President
Trego-WaKeeney State Bank, WaKeeney, KS.
(78% of all loans are for agricultural purposes)

However one needs to look at both sides and if the lenders are unable to secure a transaction the funds for financing will dry up. The packer and grain buyer need only to check the central filing in Topeka by a phone call and can ascertain whether one or more names be placed on the check. I believe this will work a real hardship on the honest borrowers and severely limit the availability of credit. It would be a dangerous blow to all in the agriculture community.

R. L. Gaskill
Farmers State Bank, Winona, KS
(83% of all loans are for agricultural purposes)

In our business we work with hundreds of farmers and to our knowledge not one of them has been financially harmed by the current law. This is something most all farmers never encounter - thank God. Naturally farmers would be initially supportive of the proposed change because it sounds good from their point of view. But beyond sounding good, this proposed legislation potentially could harm far more farmers than the current law does.

If the Uniform Commercial Code is changed it would make it even more difficult for financially marginal farmers to get credit. The risk to lenders would be excessive. For after a farmer misuses proceeds of collateral the lender most often has no means of recovering its money except to go against the purchaser of the collateral. For you see in the cases of these financially weak farmers they have mortgaged all their assets to get the credit they need. If the collateral goes, then there is not any other means for payment of the loan. Sure, the lender can sue the borrower for the money, but almosr always the borrower doesn't have anything for which to sue. He's out of assets or the remaining assets are mortgaged to another lender. So the damaged lender can spend $10,000.00 in legal fees prosecuting the borrower and not get a thing, because there is nothing to get. Without the protection of the law in its present form, you can see creditors would avoid lending to those marginal farmers.

We can appreciate the difficulty in balancing creditor rights and debtor rights, but it hardly seems to be the time to remodel those laws. The precarious financial state of many farmers and ag banks cannot stand any new laws that change the rules of the game.

Douglas R. Johnson, Executive Vice President
Guaranty State Bank & Trust Co., Beloit, KS
(65% of all loans are for agricultural purposes)

Central filing was affected after much time and effort in order to facilitate easy and inexpensive lien searches. This bank runs lien searches on our customers, and we assist or actually run lien searches for our customers buying livestock and/or grain. We can generally get one day service on such searches and can assure you it is easily accomplished. Why should the burden be placed on lenders to again make sure the subsequent buyer is aware of our lien position when we do not even know who this buyer might be. Many calves have been sold directly out of the pasture and much grain has been sold directly to feed lots, etc., eschewing both local sale barns and grain elevators. How can we notify these unknown buyers of our lien position?

The crux of the matter is that the buyer knows who the seller is and can easily run a lien search to determine any liens outstanding. A simple joint payee check will then solve his problem. I am sure any buyer needing assistance in fillng can get it from his bank. Any additional burden of this nature placed on ag banks at this time certainly cannot be construed as being beneficial to the farmer/stockman.

Robert E. Sorem, Vice Chairman - CEO
Sylvan State Bank, Sylvan Grove, KS
(68% of all loans are for agricultural purposes)

As I am sure you are aware, the farm economy in Kansas is at its lowest point in current history. Kansas farmers and ranchers are having difficulty obtaining the necessary credit needed to continue with present agricultural operations. In addition, many farmers and ranchers are attempting to expand their enterprises to create sufficient cash flow. This, in turn, requires additional credit needs and further reduce collateral margins. For these credit needs, most Kansas farmers and ranchers turn to their hometown Kansas banks.

The goal of our bank and, I am sure, most rural Kansas banks, is to provide the credit needs of our agricultural customers. In many situations, in our attempts to keep Kansas farmers in business, we have become the "lenders of last resort." This, along with depressed commodity prices, ever increasing production costs and intolerable weather, has increased the risks and the possibilities for losses for both sides of the "borrower-lender"arrangement. The addition of any further risks in agricultural financing will, undoubtedly, force agricultural lenders to restrict credit and, in some situations, refuse credit to certain borrowers. The elimination of the lien protection provision in Section 9-107 of the Uniform Commercial Code will certainly add additional risk to agricultural lending.

When proceeds from the sale of collateral securing agricultural loans cannot be relied upon for repayment, the risk will certainly increase. When risk is increased, then cost of credit will increase and availability of credit will decrease. Kansas agriculture, both borrowers and lenders, should not and cannot be asked to tolerate this burden. A portion of the future of Kansas agriculture is riding on this important aqnd difficult issue. Please do not allow actions that will further cloud the outlook of our agricultural producers.

Jeffrey R. Conner
Assistant Vice President - Agriculture
First National Bank, Centralia, KS
(51% of all loans are for agricultural purposes)

The abolishment of this provision not only would restrict the ability of lenders to continue with marginal lines but would place additional costs onto depressed agricultural borrowers and their banks.

At the present time, we as agricultural bankers are receiving continuing regulatory pressures for cash flow and increasing large margins; while farmmers are being kicked from both sides i.e., high operating costs and miserably low commodity prices. Agriculture is the backbone of our country but it is already severely strained and I don't know how many more of these straws it will take before it is completely broken down.

Eldon L. Pfannestiel
Vice President and Cashier
Bazine State Bank, Bazine, KS
(64% of all loans are for agricultural purposes)

Page 4

Ultimately, who does this law really provide protection for? The law protects the lending institution's depositors. The real lender is the depositor. Can you tell me why in our society today does there exist this notion that money deposited in a bank belongs to the stockholders of the bank and they can stand the loss. Deposits are property of the depositors, the public. Some would argue that the FDIC protects the public. Recapitalization of a bank ultimately creates more inflation, that erodes deposits as surely as a bank robbery, or illegal disposal of collateral.

The real question is not whether the law is equitable but who is responsible for determining who owns the property. If law demands the lender to protect his or her property by filing a public lien and provides a system to do so, then is it not logical the person buying agricultural products determine if the seller is the owner. Certain farm products are exceptions to clear title because there is no title or documentation available to attach a lien to.

Robert E. Alsup, President
Eric R. Fiala, VP Agriculture
The Cheyenne County State Bank, St. Francis, KS
(87% of all loans are for agricultural purposes)

However, as we are all aware, the number of farmers and ranchers in the state of Kansas who operate a profitable operation is declining daily and as the losses continue to mount the equity in their farm and ranching operation is disappearing due to these losses and also deflation in the values of practically everything a farmer or rancher owns today.

Let me assure you that as more and more borrowers from local banks in the State of Kansas lose their equity and try to survive the crisis that we are in right now, that clear title will make a difference as to whether or not credit is available to them.

There are no doubt a few instances where perhaps a livestock auction or order buyer has had problems with the lien laws covering agricultural products. However, I would be interseted in knowing if any farmer or rancher has ever had to pay twice for cattle, grain, etc. that he purchased. Furthermore, even if he has, why did he not check the lien filing before the purchase was made to see if a lien existed. °If a farmer or rancher should purchase a car or truck from an individual he must check to see if a lien exists before payment is made. If a farmer or rancher purchases real estate, a lien search must be completed before the transaction is closed. Why should a law be passed whereby the same farmer and rancher may purchase cattle, grain, hay, etc. without first checking to see if a lien exists.

E. Dwayne Walls, Vice President
Bennington State Bank, Bennington, KS
(40% of all loans are for agricultural purposes)

You are quite aware the farm products exception rarely creates any problems for the purchaser of agricultural products. Most often, the sales of such products already fall outside the exception because they are made with the express or implied consent of the lienholder. In those cases, the buyer takes free and clear of the lender's security interest. Therefore, only in a very small percentage of the cases where an unauthorized sale is made and the seller fails to pay off the lender, the farm products exception comes into play. To possibly eliminate that important section of the code would dramatically alter the lending practices creditors have used in making agricultural loans in order to cover isolated problem areas. Therefore, I do not believe it would be in the best interest of the Kansas farmers and certainly not the Kansas economy.

Statements have been made by some that agricultural people simply don't believe that they should bear the burden for checking to see if a financial institution has a lien against certain products and further indicate that this should be the responsibility of the lending institutions. I would ask, how does a lending institution check for a lien that they already have on farm products that are being sold to a third party, when the lender knows nothing about the sale? Only the buyer is in a position to make certain that neither they or the lender are jeopardized by the financially distressed farmer who may have suddenly lost his integrity.

Who are the purchasers of farm products such as livestock and crops? The vast majority are grain and livestock dealers. Individual farmers don't buy grain from other farmers in significant amounts. Farmers buy most of their livestock through commission houses or order buyers against whom they would have recourse. Thus, it is the grain and livestock dealers who have the greatest interest in clear title legislation.

I realize the search for liens entails some effort on the part of the buyer and this is why the Kansas Bankers Association worked closely with such groups as the Kansas Livestock Association and the grain and feed dealers in 1983 to get S.B. 7 of that session passed which created a central filling system for financing statements on farm products in Kansas. I believe we should give this system an opportunity to be fully implemented and prove its ability to handle the information before a change is made in this long standing section of the code relating to the farm products exception.

The removal of the farm products exception to the UCC would have the effect of substantially reducing our willingness to make certain agricultural loans. In order to maintain the same level of protection against default which is provided by the Code's exception, lenders will be forced to seek additional collateral for loans or to lend only to those farmers who could quality for unsecured loans. In any case, it would be logical the cost of credit would increase while the overall amount of available farm credit may be reduced.

While this bill would grant purchasers of farm products a certain amount of legal protection, it would in turn punish a great many more agricultural borrowers throughout Kansas. To dry up the credit supply and increase costs for many Kansas farmers and ranchers in an attempt to stop the acts of a few agricultural borrowers who are not honest and who do not repay the loans seems to me to be an unreasonable price for the agricultural producers to pay.

G. A. Schaffer, President
The First National Bank, Hoxie, KS
(68% of all loans are for agricultural purposes)

National Broiler Council

STATEMENT OF THE

NATIONAL BROILER COUNCIL

TO THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

U.S. SENATE

OCTOBER 9, 1985

ON A BILL TO

PROVIDE PROTECTION FOR AGRICULTURAL PURCHASERS OF

FARM PRODUCTS

The Madison Building-Suite 614/1155 Fifteenth Street, N.W./Washington, D. C. 20005/202 296-2622

The National Broiler Council ("NBC") is the national trade association representing the producers and processors of over 85 percent of the broiler/fryer chickens produced in the United States. NBC supports S.744 which would remedy an anomaly in commercial law that is basically unfair to the purchasers of agricultural products.

Section 9-307(1) of the Uniform Commercial Code ("UCC") provides that "[a] buyer in the ordinary course of business. .other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even if though the security interest is perfected and even though the buyer knows of its existence." (emphasis added). This means that buyers of commercial inventory take free and clear of security interests created by sellers, but buyers of farm products do not. The farm products exception is unfair to purchasers of farm commodities who must undertake searches for the existence of liens. The process in expensive, cumbersome, time consuming and in many cases entirely impractical because of the interstate movement of agricultural commodities that often makes it impossible to search for liens.

The purpose behind the general rule contained in section 9-307(1) of the UCC is to encourage the free flow of goods in commerce by protecting good faith purchasers from the risk of prior liens, thereby allowing purchasers who buy goods in a normal course of business to acquire full ownership of the goods. It would be impossible for goods to move smoothly through commercial channels if each buyer had to undertake an investigation as to the seller's ownership and authority to sell the goods. Section 9-307(1) provides the certainty that once a sale has been consummated it will not be challenged by an earlier secured creditor, unless the goods happen to be farm products.

The farm products exception thus runs counter to the policy of encouraging the free movement of goods in commerce. Under the general rule a secured lender could claim the proceeds of a sale of collateral, but it could not go after the purchaser when a seller defaults. The farm products exception, however, allows the lender's security interest to continue in both the original collateral (in the hands of a subsequent purchaser) and in the proceeds of the sale. Thus, the lender in a farm product's transaction has two alternatives to recover the debt. He can go after the individual to whom he lent the money, or he can go after the purchaser. This means, for example, that when a broiler processor pays a farmer for grain for chicken feed, he may also have to pay the farmer's lender if the farmer has failed to apply the money paid by the processor to the debt.

NBC believes that there are no circumstances or characteristics in agricultural transactions that justify the special treatment accorded to farmers' lenders. NBC therefore supports legislation that would preempt the states' ability to except purchasers of farm products from the general rule allowing purchasers in the ordinary course of business to take goods free of preexisting security interests. Limiting a lender's right to recover the debt solely from the individual to whom the credit was extended is justified in that in the normal course of doing business, the lender has presumably investigated the debtor's credit worthiness and business competence in determining whether to make the loan in the first place. It should, in fact, be part of a responsible commercial lender's normal business practices to determine the level of risk in a particular transaction. Commercial lenders also in a position to monitor the debtor's commercial conduct and to police the collateral in order to assure that the proceeds of a sale of collateral are applied to repayment of a debt. There is nothing inherently different in the sale of farm products when compared to the sale of inventory that makes it any more difficult for lenders to monitor the debtor's commercial conduct in the case of sales of farm products.

Purchasers of farm products, on the other hand, generally are not in a position to determine whether the seller is performing its obligations under a commercial lending arrangement. Purchasers are concerned primarily with the terms of a deal being struck, and not with a seller's other business affairs. Indeed, it is extremely difficult for the buyers of farm products to evaluate the risks involved in purchasing the products. Commercial sales of farm products often take place through a variety of market transactions where the original seller may not even be present or known. These include transactions through auctioneers, commission merchants and warehouses. Deals are negotiated and concluded quickly in settings where complete and reliable information about a seller's outstanding loans and security interests in particular goods are not available.

In such situations, buyers interested in protecting themselves from possible claims by a seller's bank or other financing institution have very limited viable options. The buyer could ask the seller about the existence of liens and the identity of lien holders. In such information were provided, the buyer could issue the check payable to both the seller and lien holder. Alternatively, it could seek a waiver of the lien from the lien holder. It may be, however, that the seller cannot be reached when goods are being handled through a broker or agent. Or it may be that a seller may not have at hand the details of financing arrangements covering specific goods. Often the seller may simply deny that a lien exists.

Theoretically, instead of checking with the seller a purchaser could check for the financing statement required under article 9 of the UCC to be filed by secured creditors. Financing statements are indexed in the name of the debtor and identify the lien holder and the collateral involved. Financing statements are usually located in the county of the debtor's residence, but they may also be filed where a crop is grown. In sales of farm products, however, this system is virtually useless. This is especially true in sales involving several interstate transactions where information is essentially impossible to obtain. The name of the seller may be very difficult to determine in cases where a seller uses various names for subsidiaries and operating divisions of a parent company. The identity of the county and state of residence or the location where a crop was grown may also be extremely difficult to obtain where the sale was part of a large production. In such cases, even if a financing statement were found it might reflect only a general description of the collateral, making it impossible to identify a specific lot or crop. In addition, the filing system in the various states are not consistent. What may be contained in the filing system of one state may be contained in an entirely separate system in another state, thus resulting in confusion and lost time. Moreover, because sales transactions are consummated in circumstances of great urgency, problems of distance and time make the information functionally unavailable in these types of transactions. Thus, as a practical matter, purchasers of farm products may find it impossible to determine the existence of an undisclosed security interest.

If Congress were to eliminate the farm products exception to the UCC by enacting a federal statute, lenders would no longer be able shift the risk of loss to purchasers who have no knowledge of the existence of a security interest and no actual ability to determine its existence. Placing the risk of loss on the party most likely to be able to prevent the loss is precisely what a system of commercial law should provide. For several reasons, we believe that the impact of such a change would be minimal. In one state, California, farm products financers already bear those risks. California eliminated the farm products exception to the UCC in 1976 and no great negative consequences have resulted.[*] It is, moreover, entirely possible that the net amount of losses would be reduced if the exception were eliminated. Under present market conditions, buyers are unable to predict in advance which sellers present a risk of loss by requiring a purchaser to pay twice for its goods. Buyers are also without power to patrol the seller's use of proceeds once a sale has been consumated. Lenders, on the other hand, generally are in a position to maintain continuing relationships with entities to whom they lend funds. They can police the status of collateral and demand prompt accounting for collateral that has been sold. It is probable that lenders when confronted with a change in the law that presently allows them to shift the risk of loss to innocent purchasers would minimize their risk through more careful policing techniques or more stringent lending policies.

---

[*] In addition, various types of prenotification laws have been enacted in Indiana, Ohio, Tennessee, Kentucky and Illinois which require the debtor to supply the lender with a list of potential purchasers for its products. The lender in turn is required to notify the potential purchaser for its products. The lender in order to retain the secured interest. The buyer otherwise takes clear of the interest. There has been no effect on the cost or availability of farm credit, but a lack of uniformity has resulted because of differences in state laws. For this reason, federal preemption of the farm products exception is needed to provide uniform treatment for purchasers of farm products.

Furthermore, the farm products exception is not supported by an adequate basis for its existence, and in today's commercial markets its continuation cannot be justified. Special protection for lenders whose collateral consists of farm products was the prevailing common law prior to the promulgation of the UCC in the early 1950s. The reasons for the special exception for farm products are unclear. It may be that the original objective was to protect small country banks holding mortgages on crops or livestock. The court decisions that may have provided the basis for the farm products exception came about in the late 1800s and early 1900s when there was no system for assuring protection to investors in the event of a bank collapse. Federal and state deposit insurance programs in existence now virtually eliminate the risk of bank failure. Furthermore, the federal government itself has become a major financer of farm operations under the farm credit programs of the Department of Agriculture and thus the government itself has been the major beneficiary of the farm products exception.

There is nothing in the nature of farm products transactions which justifies the continuation of a system of financing that is significantly different from that in existence for inventories of other goods or receivables. Financers of farm operations are at no great comparative disadvantage when compared to financers of other types of inventories when it comes to policing a debtor's handling of collateral and ensuring the application of proceeds to the debt. Moreover, while the farm products exception does not apply if goods are classified as inventory rather than farm products, there is no generally accepted distinction between the two. The farm products exception does not apply to goods that have been manufactured, but the same goods may be classified as farm products in one case and inventory in another. Thus, the fact that the stage the goods have reached in the market may determine whether the special protection is still available to a lender illustrates the point that there is no great distinction between farm products and inventory that justifies the significant difference in treatment afforded under the UCC.

In summary the continued existence of an exception to the UCC which may result in purchasers of farm products having to pay twice for their goods, once to the seller and once to the seller's lender, is inequitable and cannot be justified in the commercial conditions that exist today.

National Conference of Commissioners on Uniform State Laws
645 North Michigan Avenue, Suite 510, Chicago, Illinois 60611-(312) 321-9710

John M. McCabe
Legislative Director

1985 OCT -7 AM 8 59

October 4, 1985

Senator Jake Garn, Chairman
Banking, Housing & Urban Affairs Committee
Room 505, DSOB
Washington, DC 20510

Dear Senator Garn:

The Senate Agriculture Committee and Senate Banking Committee are considering S. 744, which is the comprehensive farm bill. Among the matters addressed in this bill is the preemption of state law governing security interests taken in farm products. Specifically, the bill would preempt Section 9-307(1) of the Uniform Commercial Code, in which farm products form an exception to the usual rule that a "buyer in the ordinary course of business" takes free of any security interest in goods purchased.

The Uniform Commercial Code (UCC) was promulgated by the American Law Institute and the National Conference of Commissioners on Uniform State Laws (ULC) originally in 1951. The UCC has been adopted in every state in the United States except Louisiana. Thus, what Congress would do in adopting provisions contrary to UCC provisions is to encroach upon law that has long been the exclusive domain of the states and in which the issue of uniformity has been, almost completely, endorsed by the states. It would seem highly inappropriate for Congress, at this late date in the development of commercial law, to impose a new rule upon the states, especially one that is so blatantly a favor to limited special interests.

Anybody who has paid any attention, recently, recognizes that farm policy is a critical issue for Congress in this session. The language in the farm bill that would preempt the UCC provision has nothing to do with protection of the farmer, the basic producer. In fact, elimination of this exception may make credit less available to the farmer, since it will impose an extra burden on farm lenders. The beneficiaries of the provision will be large agribusiness entities, not the farmer. In a time when the basic producer is threatened, making credit less available to that producer seems to be contrary policy.

The UCC seeks to provide a fair balance in all commercial transactions, that universe of sellers, buyers and lenders that is enormously complex and often delicately organized. The "buyer-in-the-ordinary-course" rule facilitates the fundamental activity of buying and selling goods in most contexts. A buyer in ordinary course of business is "a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind..." If every buyer had to be concerned with, or subject to, the security interests imposed on every seller, commerce in most goods would be considerably impeded.

In most commercial transactions, the UCC drafters assumed that lenders could take care of themselves. The "buyer-in-the-ordinary-course" rule cuts off a lender's interests only when the buyer does not have actual knowledge of the security interest. The buyer is simply not held to the constructive notice of a security interest because it is of record when a financing statement is filed. Lenders who worry about these matters (and most probably do not) can serve actual notice on buyers, or require sellers to give actual notice, to preserve any security interests. Of course, creditors are protected under Article 6 of the UCC in the event of a "bulk transfer" of inventory. They also are protected in most jurisdictions when there is a fraudulent transfer of collateral. So, lenders have accepted the "buyer-in-the-ordinary-course-of-business" rule and the risks inherent in it, otherwise.

But farm products have always been regarded as a different problem. Perhaps conditions of production and its financing have changed to the degree that the issue of "buyer in the ordinary course of business" should be re-evaluated. But before acting precipitously, the reasons for the exception should be evaluated.

To begin with, farm products are mostly fungible goods. They also do not even become goods until there is some action taken, either symbolically or actually, to sever them from the real estate. In other words, as collateral, they lack a kind of solidity that makes them ideal. A security interest taken, therefore, can be more easily eroded than is the case with most other kinds of collateral.

Farm products are seasonal. They do not allow inventory financing in the same manner as goods that are manufactured and available without regard to time of year. They are, also, variable, dependent upon weather, farming techniques, and the quality of the land upon which they are raised. All of these factors make farm products less than ideal collateral.

When farm products are harvested, they are generally sold or stored with other products of the kind - out of the hands of the farmer - and are moved in quantities by large entities engaged in storage, buying and resale. This system does not inspire lender confidence, either.

Also, farm lenders, as a class, have been viewed as more vulnerable to failure than other lenders. Creditors in farm communities have been, historically, small, local banks which have made it their business to serve local farmers. Their smaller size and the ordinary risks taken in farm lending, anyway, have justified more protection than is the case for other lenders. Also, buyers have been, historically, large, agribusiness entities that operate interstate. They have been perceived as better able to assume the risk of loss than small farm lenders are.

There is, also, the fact that farmers have never been regarded as mere businessmen. After all, the food supply is the most critical part of any economy. And farming is regarded as a special part of American culture.

Farmers have received treatment and continue to be treated as more than businessmen, and their lenders have been encouraged to lend money based on different standards than is the case for commercial lending. For all these reasons, farm lenders have been given a little extra protection in the UCC.

No doubt, farming has changed and will continue to change. Dwindling farm populations signify that something is going on. Farm lending has changed, too. Not only do federal institutions extend large-scale credit to farmers, but small banks are becoming large banks by growth and merger. The fact that fifteen states have tinkered with Section 9-307(1) indicates that re-evaluation of the issue is probably needed.

Article 9 of the UCC was amended in 1972. Amendment to Section 9-307(1) was considered, but rejected. The Permanent Editorial Board for the UCC did suggest in its report at the time that states could repeal the exception by deleting the language "other than a person buying farm products from a person engaged in farming operations" from Section 9-307(1). Such an amendment would not do violence to other UCC provisions. However, no other official action was taken.

Because of current concern, the Permanent Editorial Board has commissioned a study of the issue, and may have its recommendations ready by early 1986. The Permanent Editorial Board does not take its responsibilities lightly. The existing fifteen amendments to Section 9-307(1) have impaired uniformity. Rest assured, serious attention will be given to the problem. If there are amendments, they will take changed conditions into account in the context of all commercial transactions. And the amendments will be appropriate.

This cannot be said of the language in S. 744 before the Senate Committees. The bill suffers from inadequate drafting, limited understanding of commercial law, and favoritism to interests beyond, even, any reasonable need for reform. Difficulties begin with the definitions.

S.744 derives a definition of "buyer in the ordinary course of business" from the general definition in UCC Section 1-201(9). However, in the effort to limit this definition to the purposes of the bill, it refers to "farm products," rather than "goods," and "person engaged in farming operations who is in the business of selling farm products" instead of "person in the business of selling goods of the kind." But what are "farming operations?" While "farm products" are defined in the S. 744, "farming operations" are not defined. Do "farming operations" mean something more than a farmer engaged in the basic task of raising crops or livestock?

The UCC quite clearly limits the farm product exception in Section 9-307(1) to transactions between the farmer, the initial producer, and his or her immediate purchaser. The ambiguity of the term "farming operations" might lend to a claim of right under S. 744 for entities other than the initial producer of farm products. The bill would do more than correct a perceived problem with UCC Section 9-307(1), if that is the case.

The most serious problem for S. 744 arises from a conflict between the definition of "buyer in the ordinary course of business" and those provisions of the bill that purport to eliminate the UCC exception. In the bill, "buyer in the ordinary course of business" is defined as a person who "buys the products in good faith and without knowledge that the sale is in violation of the ownership rights or security interest of a third party in the products."

But the operative provisions of the bill permit a "buyer in the ordinary course of business" to "take free of a security interest.....even though the buyer knows of its existence." The bill defines the word "know" as meaning "actual knowledge."

The dilemma is apparent. If there is actual knowledge of the security interest, there can be no "buyer in the ordinary course of business." On the other hand, the buyer takes free of a security interest that he knows about. What is one to make of these provisions? The conflict is so all-pervading that a court would have great difficulty in reconciling them.

Given the conundrum presented by these provisions, the operation of the subsequent notice provisions is, also, unclear and potentially unsettling to the financing of farm products. A buyer can be made subject to a security interest if the secured party or seller gives written notice of the security interest to the buyer. Can this be interpreted to mean that any buyer, whether or not a "buyer in the ordinary course of business," is not subject to any security interest unless such notice is given in the formal fashion the provision requires? The conflict between the definition of "buyer in the ordinary course of business" and the language that purports to abolish the exception for farm products tends to magnify the importance of these notice requirements. Reliance upon them in any situation of doubt is a predictable recourse in any court, and the effect may be abolition of the "buyer in the ordinary course of business" in many cases where farm products are concerned. That, of course, would put buyers of farm products in a favored position not given to the buyers of any other kinds of goods. It is a position that, probably, would not be tolerated with respect to buyers of any other kinds of goods. It should not be tolerated where farm products are concerned.

Beyond the issue of buyers and "buyers in the ordinary course of business," S. 744, also, attempts some innovations not prompted by anything in the UCC. These innovations are found in the provisions pertaining to "commission merchants" and "selling agents." There is nothing in the UCC quite like a "commission merchant in the ordinary course of business" or a "selling agent in the ordinary course of business." In fact, buyers, commission merchants, and selling agents would seem to be quite different entities. (Neither commission merchant nor selling agent is defined in the farm bill.) Principles of agency or bailment would seem to apply to these latter two entities. Would UCC concepts apply?

It seems doubtful, but that is what S. 744 appears to do. Note that the language excepting selling agents and commission merchants from a security interest does so, "though the security interest is perfected." A basic question ought to be, "What relevance is perfection to these entities?".

A security interest in farm products (like all tangible goods not in the possession of a creditor) is perfected by filing a financing statement in the appropriate public record. The filing establishes priority among creditors and is constructive notice to third parties (except buyers in the ordinary course of business) of the existence of the security interest. But are "selling agents" and "commission merchants" third parties to which such notice is effective?

Assume that principles of agency apply. The agent, generally, stands in the shoes of the principal - is held to know what the principal knows. Actual or constructive knowledge is irrelevant. The fact of the relationship is sufficient enough. If there is a bailment, it seems that any knowledge of a security interest on the part of the bailee may be irrelevant. So what can a provision that says a "selling agent" or "commission merchant" is not subject to a security interest, "even though the security interest is perfected," really mean?

If the intent of S. 744 is to favor certain agribusiness interests by absolving them of prior security interests, the above described provisions are highly likely to fall short of that intent. These provisions simply muddle existing law without gain to anyone. This is not to suggest that fulfilling that intent is good policy. Much of what is intended in this bill seems wholly unwarranted. Agribusiness would be free of security interests in a way unheard of in any other area of commerce. But the current provisions of the bill serve nobody's interest well, except lawyers - who will profit from the litigation.

There is no crisis pertaining to the issue of the farm products exception under the UCC. The debate on the issue has gone back and forth for over a decade. There is no evidence of serious problems that justify congressional action. The states will take care of their own problem after it has received serious and balanced attention by the institutions that serve state government. Congress should drop the issue from the current bill. If it passes the provisions of the current bill, it will enact legislation that merely confuses existing law. Such an encroachment on state powers would, in the end, prove highly embarrassing.

Sincerely,

John M McCabe

John M. McCabe
Legislative Director

JMM:cms

national grange

1616 H STREET, N.W. WASHINGTON, D.C. 20006 (202) 628-3507

GRANGE

Edward Andersen, Master

October 8, 1985

The Honorable Jake Garn, Chairman
Senate Committee on Banking, Housing and
  Urban Affairs
SD-534 Dirksen Senate Office Bldg.
Washington, D.C. 20510

Dear Mr. Chairman:

The National Grange strongly supports S. 744, a bill which will (1) treat farm products on an equal basis with all other products; (2) allow consistency among and between the states; (3) remove obstructions to free trade and orderly marketing and (4) relieve farm product purchasers from the "double payment" risk. In addition, S. 744 provides protection to sales agencies and auction barns that sell the agricultural products of others if such sales are in the ordinary course of business. At the present, lending institutions collect liens on livestock that are sold through auction barns, etc. from the selling agency even though they have no previous knowledge of the existence of the lien.

The "clear title" proposal, as contained in S. 744, would supersede the farm products exemption found in the Uniform Commercial Code. The Code states the general rule that purchasers are not subject to unsatisfied security interests (mortgage or lien) on the products they buy, but, there is an important exception to the general rule. Only agricultural buyers (who often are farmers themselves) run the risk of having to pay twice for their purchases. At least 16 states have taken legislative action to relieve the burden on agriculture; however, there is no clear consistency nationwide, which leaves purchasers of goods that are shipped via interstate subject to different laws.

The "clear title" proposal is not expected to adversely affect agricultural credit. Historically, farm products exemption in the Code was thought to provide extra credit protection for the banking industry; thus, increasing the availability of farm loans. This rationale is now suspect since bank deregulation has enabled the banking industry to better serve rural communities. Several states - Illinois, Ohio, Indiana, Kentucky, Tennessee and California -- have adopted similar legislation with no identifiable impact on interest rates or credit availability.

U.S.D.A. reports that illegal conversion, the failure of the seller to pay the lender after agricultural products are sold, is relatively infrequent. Farmers Home Administration records show that for 1983, third party conversion cases totalled approximately $3.9 million, of which only $1.4 million was recovered. This hardly justifies the cost of litigation. Transferring the risk of conversion to lenders is unlikely to affect interest rates.

The Honorable Jake Garn
October 8, 1985
Page 2

The National Grange respectfully recommends that your Committee approve S. 744 without amendment and report it to the full Senate in time for it to be included in the 1985 Farm Bill.

We would appreciate this letter being made a part of the hearing record on S. 744. Thank you.

Sincerely,

Edward Andersen, Master

EA/pkh

NATIONAL
INDEPENDENT
DAIRY-FOODS
ASSOCIATION SINCE 1957

321 D STREET, N.E. WASHINGTON, DC 20002, (202) 543-3838

October 10, 1985

Chairman Jake Garn
Committee on Banking, Housing
and Urban Affairs
U. S. Senate
Washington, DC 20510

Attention: Mr. James E. Boland

Dear Chairman Garn:

Enclosed are the comments of the National Independent Dairy-Foods Association (NIDA) concerning S. 744. Our association offers these comments for the written record of the October 9, 1985 Senate Banking Committee hearing regarding S. 744.

The National Independent Dairy-Foods Association is the largest national association which exclusively represents independent dairy processors. Our comments reflect the position of independent milk handlers and the dairy processing industry. We request that they be made part of the hearing record.

Best wishes.

Sincerely,

Donald A. Randall

Donald A. Randall
Executive Vice President/
General Counsel

DAR:bc
Enclosure

A merger of National Independent Dairies Association and National Association For Milk Marketing Reform

NATIONAL
INDEPENDENT
DAIRY-FOODS
ASSOCIATION
SINCE 1957

321 D STREET, N.E., WASHINGTON, DC 20002, (202) 543-3838

COMMENTS OF NATIONAL INDEPENDENT DAIRY-FOODS ASSOCIATION ON A BILL TO PROTECT THE PURCHASERS OF MORTGAGED FARM PRODUCTS

Hearing: October 9, 1985 on S. 744

Our association, which represents the largest organized group of independent dairy processors, manufacturers and distributors, offers its comments on the mortgaged farm products problem, specifically concerning the risk of double payment for milk. We can best illustrate the problem which our processors face in certain areas of the country when purchasing milk which is covered by liens, with an actual case in South Carolina. Before we get into the specific case, the problem of the unprotected purchasers of fluid milk, with or without actual notice of any liens, is somewhat different from grain and livestock because of extensive federal and state regulation.

There are forty-four (44) federal milk marketing orders and the payment terms of the orders vary. The three general methods of payment are directly to individual producers, to the cooperative which had producer contracts and is certified to receive payments for producer members, and to the market order administrator who then disburses payment to producers under the order. It is clear that the highly regulated markets for milk, whether one of the forty-four federal orders, or one of the states, may affect the liability of the buyer to lenders of bankrupt or absconding dairy farmers. In recent discussions with agricultural marketing administration officials at USDA, we are told that the problem of double payment for milk from mortgaged dairy cattle is not an unusually large one. Although these officials state that they are not able to list numbers of specific instances of buyer liability in recent years, the problem and the threat exists for many milk handlers and processors. The Farmers Home Administration (Fm.H.A.) is the agency of USDA which is directly involved in agricultural loans and liens, and affected by this bill.

A special circumstance with milk is that under most federal orders and state regultions, milk is paid for on a delayed basis. For example, a partial payment for milk in the Chicago Regional Market Area, Order #30, is made to producers by handlers (dairy processors) on or before the third day after the end of the month for milk received during the first 15 days of the month. Also, on or before the 18th day after the end of the month, handlers pay for the remainder received during the month and a uniform price adjustment for the entire month's supply. This delayed payment is some insurance against the double payment possibility. However, there is no immunity from double payment under federal milk marketing regulations.

The specific case problem we have referred to arose in South Carolina which has no federal order, but is regulated by a State Milk Commission. State regulations were not involved in the matter. The processor described the problem this way:

> "We are a family-owned milk processing and distribution operation. We have been in business since 1920; have been doing business with individual independent dairy farmers, who supply our dairy with its raw milk needs. Like all business operations,

these farmers need financing and have several sources from which they borrow funds. They often contract for feed, fertilizer and other supplies to be paid for over a period of time. In the course of farmers' dairy businesses, they are making payments on loans and on other contracts for feed and supplies. Sometimes we are asked to accept an assignment against the farmer's milk check. This we have done for many, many years. We have always assumed that when we purchased the milk it belonged to the farmer and that we owed him for this milk. Upon accepting the assignment we request a written statement, or a signed form, from the farmer authorizing our dairy to deduct certain amounts for specified periods of time. Many times the farmers have called and requested, or written and requested changes in these assignments, either in amounts of money, number of payments, or delaying payments for a number of months. We have honored many of these requests.

We have had no problems until April 8, 1981, when we received a letter from Farmers Home Administration stating that we owed them $103,000.00 for milk purchased from one of the dairy farmers supplying us fluid milk for years. This farm had gone out of business and owed Fm.H.A. a balance of $103,000.00. Fm.H.A. claimed that we were liable since no other funds were available and we had purchased the milk from this particular farmer, and that this milk was mortgaged to Fm.H.A.

Our dairy was not aware, and never had been aware up until this time, that milk which was not yet produced was mortgaged or could be mortgaged. We had always believed that our purchase was made from the individual farmer and that any monies we paid for the milk belonged to the farmer, and we had honored his request for any deducts or any assignments against his check.

It is our belief that our dairy does not owe Fm.H.A. $103,000.00 as we had paid to this farmer in full for all milk shipped to our plant. It is difficult for us to believe that milk can be mortgaged and we could be liable for the debt of the farm producing the milk even though we may never know that such a mortgage is there. We have always cooperated with Fm.H.A. in making the deductions and have done considerable bookkeeping, and have gone to considerable extra costs to honor their requests."

The Uniform Commercial Code is in effect in South Carolina and there is no change in the farm products exception in UCC 9-307(1). Milk is a farm product under UCC 9-109(3) as it is the product of livestock. In this case, Fm.H.A. evidenced its lien by a financing statement and security agreement which had been executed and which was acknowledge and accepted by the dairy processor. The problem which is apparent in this case is rooted in the failure of Fm.H.A. to immediately inform the processor of the fact that it was not receiving the assigned $5,150.00 per month. The processor misplaced his trust in the farmer and relied upon his statements.

As to filing, the problem of locating and searching for Fm.H.A.'s financing statement and security agreement in the counties is obvious. It is a burden which is time consuming and expensive. Fm.H.A.'s regulations in 7 CFR 1941.57 require filing as follows:

> "Ordinarily, in states which have adopted the UCC, financing statements may be delivered by hand or mailed to the filing officers for filing or recording . . . The financing statement will be filed or recorded as required by state supplements.

The problem in South Carolina really didn't involve the burdensome checking of numerous county court houses, but this is necessary in other cases, and other states.

NIDA believes that the problem for dairy processors generally, can be relieved by legislation such as S. 744 because milk is specifically included as a farm product and it protects the buyer in the ordinary course of business. This nationwide approach can be beneficial. Also, NIDA supports the limitation on Fm.H.A.'s right to proceed against buyers of farm products, or at a miminum, to require Fm.H.A. by law or regulation to diligently supervise its debtors and to give actual notice, by registered mail, immediately, of any security interest in farm products, and any change in that interest. Also Fm.H.A. should give immediate notice to buyers of any delinquency if Fm.H.A. has been assigned payments. If this fails to occur, then buyers should be released.

The National Independent Dairy-Foods Association supports S. 744 which is a reasonable and workable means to eliminate the danger of double payment.

STATEMENT OF THE
NORTH DAKOTA BANKERS ASSOCIATION
ON S. 744
COMMITTEE ON BANKING, HOUSING & URBAN AFFAIRS
UNITED STATES SENATE
WEDNESDAY, OCTOBER 9, 1985

PRESENTED BY WILLIAM M. SANGER
NDBA PRESIDENT - WAHPETON, NORTH DAKOTA

The North Dakota Bankers Association, representing 173 of the 178 state and nationally chartered banks in North Dakota, appreciates this opportunity to present its concerns about S. 744 that would eliminate the "farm products exception" from Section 9-307(1) of the Uniform Commercial Code. The North Dakota Bankers Association is unalterably opposed to this legislation and encourages this committee to not recommend its passage.

Regulation of commercial transactions has traditionally been left to the states. The record will clearly illustrate that this system has worked and continues to work extremely well. Congress should not be concerned with isolated difficulties when the "solution" would cause great harm to lenders and farmers alike. To shift the burden of guaranteeing the security of farm products as collateral from the buyer to the lender does not solve the problem of the farmer who fails to repay a secured loan to which he earlier legally agreed.

It is important to state at the outset the main reason why North Dakota bankers consider this issue to be of ultimate importance. We are pledged to provide maximum credit at minimal cost to benefit the most important industry in our part of the country -- agriculture. Maintaining the farm products exception is essential to continuing this situation. Farm products can easily be moved around and co-mingled with other farm products, thus quickly losing their identity. It is virtually impossible for a lender to know the exact location of grain and livestock for each of his farm customers at any given moment and in particular, when and where a sale might occur. Since a purchaser obviously has knowledge of such sales of farm products, state law has provided that it is their responsibility to check for existing liens.

- continued -

Such checks are a relatively simple procedure. In North Dakota, we have recently concluded nearly three years of deliberations between lenders and buyers to develop a system that fairly protects the interests of all parties involved. Through the dedicated and diligent efforts of these many individuals, we achieved success in 1985 with the adoption of a central notice system that becomes operational on January 1, 1986. It would be disheartening, as well as unnecessary, to have S. 744 obliterate the provisions of our hard earned state law and many other states' laws as well.

Without solid assurance that the proceeds from a sale of farm products will be applied to a farmer's existing loans, banks will be forced to view any loan where farm products are used as collateral to be unsecured. Due to today's rugged economic situation in agriculture, the need for collateral is becoming far more prevalent rather than less so. Unless other collateral is available, banks would be forced by the passage of S. 744 to decide whether the customer is eligible for unsecured credit and, even if they are, at what rate.

It is important to understand the full implication of considering such loans to be unsecured. There are strong indications that federal and state bank regulators would treat such loans as unsecured and that they would look exclusively to "cash flow" as the determining factor on whether a specific loan is "sub-standard" or "non-performing". This could only result in more existing farm loans being classified, placing the lender in a position of being extremely reluctant and unable to make any new loans if those were to be considered unsecured.

This is hardly the time for Congress to be considering bills that will restrict farm credit rather than expand the opportunities to extend such credit to otherwise qualified borrowers. However, this is exactly what passage of S. 744 would accomplish.

- continued -

The problems involved in the overall financing of agriculture today are becoming more and more complex. They warrant careful examination and study. Elimination of the farm products exception by S. 744 would be totally counter productive and its timing today could not be worse. The agricultural economy is terribly distressing to lenders and all other parties involved in agriculture as well. The farm products exception in the UCC is the only avenue open for us to properly serve a growing number of farm borrowers. The provision is also essential for us as bankers to be able to properly protect the ultimate holder of the dollars -- our customers. As depositors, their protection is first priority. Likewise, it is important that farmers be permitted to use their assets to finance their enterprises. This is currently allowed through the UCC and should not be done away with by S. 744.

It should be noted again that this is an issue that has always been adequately settled at the state-level by legislators who intimately understand the unique nature of each state's agricultural economy. For Congress to pass a law preempting all existing state laws is more than a violation of states' proper rights -- it displays an unwarranted disregard for the special problems faced by the agricultural communities in each state, particularly when North Dakota and many other states are suitably addressing this issue.

On behalf of the North Dakota Bankers Association, I commend the Senate Banking Committee and its leadership for securing referral of S. 744 so that this public hearing could take place.

# # # # # # # # #

PBA

717 255-6911
23 NORTH FRONT STREET • POST OFFICE BOX 152 • HARRISBURG, PENNSYLVANIA 17108 • TELEPHONE [redacted]

THOMAS B. SHRIVER
Executive Vice President

October 4, 1985

Dear Senator Heinz:

I am writing on behalf of the Pennsylvania Bankers Association which represents 319 commercial banks in the Commonwealth, and, in particular, those institutions which engage in agricultural lending. It is the PBA's understanding that the Senate Banking Committee will hold hearings on S.744, the Farm Products Mortgage Act, on October 9. I also understand that S.744 may be offered as an amendment to the Farm Bill the week of October 14. The PBA is in complete support of the position of the American Bankers Association in oppositin to S.744 which would preempt the farm products exception of the Uniform Commercial Code as adopted by Pennsylvania and other states.

It is the conclusion of Pennsylvania's agricultural lenders that federal preemption of this exception would adversely affect private-sector lending to the already financially distressed farming industry. In addition, the PBA believes that the uniformity of commercial transactions regulated by state versions of the UCC is imperative and that preemption of such state law by Congress would be counter-productive.

The PBA appreciates the Senate Banking Committee's granting a hearing for input on this issue. In lieu of a request for permission to present formal testimony, I respectfully request that you request that Chairman Garn introduce this letter as a statement for the record of the hearing on S.744.

I would be available to discuss this issue with either you or your staff at your convenience.

Your consideration of this matter will be greatly appreciated.

Best regards,

cc: Senator Jake Garn
Senator William Proxmire
Senator Arlen Specter

Pennsylvania Bankers Association

Every man owes some of his time to the upbuilding of the profession to which he belongs —Theodore Roosevelt

THE ROBERT MORRIS ASSOCIATES
NATIONAL OFFICE PHILADELPHIA NATIONAL BANK BUILDING • PHILADELPHIA, PA • 19107
ESTABLISHED 1914 • THE NATIONAL ASSOCIATION OF BANK LOAN AND CREDIT OFFICERS

EDWARD J. WILLIAMS
President RMA

Treasurer
Brown Brothers Harriman & Co.
59 Wall Street
New York, NY 10005
(212) 483-5451

October 17, 1985

The Honorable Jake Garn
Chairman
Committee on Banking, Housing and Urban Affairs
United States Senate
534 Senate Dirksen Office Building
Washington, DC 20510

RE: S. 744-UCC Farm Products Mortgage Bill

Dear Mr. Chairman:

Robert Morris Associates, the professional association of commercial lending and credit officers, is writing this letter to express its opinion for the record in opposition to the enactment of S. 744, the Uniform Commercial Code Farm Products Mortgage Bill.

The purpose of S. 744 is to shift the burden of ensuring the security of farm products as collateral from the buyer of such collateral to the lender who extended credit to the farmer. This shift would be done by eliminating the farm product rule from the Uniform Commercial Code. We oppose this because it could have severe economic consequences for farmers and for agricultural lenders and because it is not desirable to have Congress preempting the Uniform Commercial Code.

Article 9 of the Uniform Commercial Code provides a means for a lender to secure its collateral by filing a security agreement at the place designated in the UCC. The security interest in the collateral continues in effect notwithstanding sale, exchange, or other disposition by the debtor unless the secured party authorizes such action. An exception is created for business inventory (Section 9-307(1)). A buyer in the ordinary course of business may purchase the inventory free of a security interest created by the seller even though the interests are perfected. This exception was created to encourage the marketability of goods and protects the rights of retail buyers who assume that they have a clear title to the goods they purchase. The preference is for sales transactions over secured transactions.

October 17, 1985
page two

Farm products have traditionally been excluded from the laws which apply to inventory. In 38 states, the UCC contains an explicit exception for farm products (Section 9-307(1)). Farm products are not included among the inventories that are considered to be in the ordinary course of business. There is a long tradition of special legal treatment for farm products behind this exemption. The two principal pre-UCC inventory security statutes, the Factors Liens Acts and the Uniform Trust Receipts Act, provided that a good faith buyer in ordinary course took free of any security interest. Neither of these statutes applied to farm products collateral.

Under the UCC, a person buying farm products from a person engaged in farming operations does not take free of a security interest created by the lender. To protect themselves, buyers must check for perfected liens in whatever location is designated by state law. Seventeen states require central filing for convenient checking and eleven states require double notice by which the lender must file a security interest and a buyer must receive actual written notice of that interest.

S. 744 would repeal the farm products exception and shift the allocation of risk to the lender. The UCC has purposely given farm lenders added protection to encourage them to advance money on farm collateral. Because of this added protection, many marginal or financially distressed farmers are provided with essential financing. By increasing the risk to the lender, the net result of S. 744 will probably be fewer and more costly loans for farmers. This is the last thing the farm economy and individual farmers need at this time. In our opinion, the effort to shift the risk is an unwise move at any time, but it is particularly unwise considering the present condition of the agricultural economy.

In addition to our deep concern about the economic impact that the enactment of S. 744 would have on the farm economy, farmers, and agricultural lenders, we have some concern about the procedural aspects of Congress preempting provisions of the Uniform Commercial Code. The regulation of commercial transactions has traditionally been left to the states. The American Law Institute and the National Conference of Commissioners on Uniform State Laws expended considerable effort devising the Uniform Commercial Code. The National Commissioners have procedures for recommending amendments to the UCC. Indeed, in 1972 and in 1978, the farm products rule was reconsidered by the National Commissioners and left unchanged. Congress should not take action which might undermine the integrity of the UCC and the process by which the states have successfully provided uniformity for commercial transactions.

As lending and credit officers, we are aware each day of the importance of collateral in the financing of the agricultural sector of our economy. It is our opinion that if this change is made, many farmers now getting financing because of their ability to post the collateral and because of the protection granted to the lender by the UCC will not get such financing in the future. We urge the Committee not to pass S. 744.

Sincerely,

/dcl

SOUTH DAKOTA BANKERS ASSOCIATION
106 W. Capitol Box 1081 Telephone 605/224-1653
PIERRE, SOUTH DAKOTA 57501

DATE: October 09, 1985

TO: SENATE COMMITEE ON BANKING, HOUSING AND URBAN AFFAIRS

FROM: SOUTH DAKOTA BANKERS ASSOCIATION

SUBJECT: TESTIMONY ON S. 744

S. 744 amends the Agriculture and Food Act of 1981 by adding a new section providing federal preemption of the "farm products exception" in the latest (1978) official text of the uniform commerical code (UCC). Under the "farm products exception", a person buying farm products from a person engaged in farming operations does not take free of a security interest created by the lender. To protect themselves, buyers must check for perfected liens in whatever location is designated by state law.

The federal government has generally deferred to the states in the regulation of business and commercial transactions, especially in the area of secured lending, since security rights are regulated by state law. The UCC provides for state control while fostering uniformity. This Association believes that this traditional and wise policy should continue to be followed by the Congress of the United States.

When a bank or other financial institution makes a loan to a farmer or rancher for the purpose of raising crops or livestock, those anticipated farm products usually are collateral for the loan. This is a simple procedure for the agricultural borrower and lender alike. The arrangement has been a satisfactory one for decades.

The farm products which form the collateral for these loans are goods which are regularly moved from place to place and have no unique identity. It is nearly impossible for an agricultural lender to keep track of the location of each customer's farm products. It is also possible that the sale of crops or livestock may occur at any time. The UCC was drafted to place on the buyer of farm products the responsibility for checking for existing liens. It is a practical way to protect all interests. Shifting the burden of guaranteeing the security of farm products collateral from buyer to lender does not solve the problem of the farmer who fails to repay his secured loan. That loan is still unpaid.

To eliminate the "farm products exception" would have a detrimental effect on the availability of farm credit in the state of South Dakota. This detrimental effect would cause the greatest hardship for those agricultural borrowers who find themselves in the present economic doldrums. You may be told that S. 744 will benefit farmers and ranchers --the agricultural borrowers. In the real world, that is a most horrendous misstatement of the consequences! In reality, the passage of S. 744 would be a convenience for grain dealers and packing houses and others who buy farm products in a commercial sense. The real world scenario shows us that the consequences of S. 744 will exacerbate the already perilous situation of our farmers and ranchers in South Dakota.

The members of the South Dakota Bankers Association commend you for your efforts in hearing the full story on this most troubling piece of legislation. Our Association represents all of the commercial banks doing business in the state of South Dakota. Your efforts in stopping S. 744 will be appreciated.

Respectfully yours,

J. I. MILTON SCHWARTZ
Executive Vice President

JIMS/tlh

Utah Cattlemen's Association
Publishers of The Utah Cattleman

One fifty South Sixth East • Salt Lake City, Utah 84102 • 355-5748
Suite 108

Testimony on behalf of the

UTAH CATTLEMEN'S ASSOCIATION

Regarding:
S. 744
Agricultural Clear Title

Before

Chairman Jake Garn
U.S. Senate Banking Committee

Submitted by

Dick Probert, President
Utah Cattlemen's Association

October 9, 1985

Testimony on behalf of the
UTAH CATTLEMEN'S ASSOCIATION
Regarding - S. 744
Agricultural Clear Title
Before - Chairman Jake Garn
U.S. Senate Banking Committee
Submitted by - Dick Probert, President
Utah Cattlemen's Association
October 9, 1985

As a cow/calf cattle rancher from Scipio, Utah, and current president of the 109 year old Utah Cattlemen's Association, it's with a great deal of concern that I write to you, Senator Garn, concerning Agricultural Clear Title as outlined in S. 744. It is my understanding that my thoughts and this written response will be conveyed to your committee by our able national president, JoAnn Smith, which we heartily endorse and support. Cattle ranchers have been known to be plain spoken on issues that affect them and seem to be as straightforward as supporting motherhood, apple pie and our American way of life.

If I may I would like to be just as candid with my brief comments on clear title for agricultural commodities. **Cattlemen need clear title for livestock that they purchase.**

Clear title as its currently written is nothing but a bankers good judgment insurance that we in the cattle business and other agricultural sectors are paying for without receiving any premiums. If I buy a purebred range bull for thousands of dollars out of Texas, transfer that animal to my Utah ranching operation to later find out that the breeder I purchased this bull from did not honor a loan which this particular bull was used as collateral, I could not stand to pay for that animal twice nor would it be fair as an innocent buyer. Thus is the problem with not having clear title that would affect my very existence raising cattle.

Rest assured that this is truly a national problem as our cattle industry and marketing patterns recognize no state boundaries as my calves might end up in feedlots from Idaho to Kansas or be moved to the Black Hills as stocker animals.

I would sincerely hope and encourage not only your most honored Senate Banking Committee but the entire Congress to support and take immediate action to learn from the mistakes of individual state loss dealing with this interstate commerce. This bill would correct a serious economic iniquity from those of us that make our living feeding the world and at the same time would still protect lenders as they could notify buyers of existing liens. Seriously, the burden rests entirely on buyers of agricultural commodities to check for any existing lien. This change would shift some of the burden back to the lender and borrower who have the contractual relationship. The lending community would only lose the benefit of being able to go after an innocent third party buyer, upon seller default, but the bank still retains the ability to go after the seller.

Thus the clear title concept before you, simply eliminate the current good judgment insurance that the bankers have been utilizing at the expense of honest agricultural buyers.

I implore you to support clear title as not only chairman of the Senate Banking Committee and national senate leader, but as my senator and senator for the $1.3 billion livestock industry of our great state of Utah. I can't express my personal and our association membership's feelings completely of what a high priority we place on the successful passage of clear title with the 1985 Farm Bill. I stand willing and able to address more detailed information on clear title if it would be helpful to you.